

**THE INSTITUTE OF CHARTERED ACCOUNTANTS  
OF  
PRINCE EDWARD ISLAND  
COUNCIL INTERPRETATIONS  
(Under powers contained in By-law 40)  
Current as of September 7, 2012**

**INTRODUCTION:**

Administration of the rules of professional conduct, and their enforcement, is the responsibility of the Institute Council. It is one of the prime functions of Council to give guidance to individual members and students on questions of ethics. When in doubt, therefore, members and students should not hesitate to seek advice from Council concerning any problem of an ethical nature or concerning the ethical propriety of a proposed course of action in connection with their professional work.

The Council publishes, from time to time, Interpretations on professional conduct matters. These Interpretations are made by resolution under the authority of By-law 40 and are issued for the information and guidance of members and students. They should be read in conjunction with the rules of professional conduct, including the Foreword and the Application section.

**CI 102—Matters to be reported to the Institute**

1. Rules 102.1(a), 102.1(c), 102.1(d) 102.2 and 102.3 identify certain matters which must be reported to the Institute by members, students and firms.
2. Rules 102.1(b), 102.1(e) and 102.4 identify matters where a decision as to whether the matter should be reported to the Institute requires the exercise of professional judgment.
  - (a) Compliance with Rule 102.1(b) will require the exercise of professional judgment to determine whether a serious criminal offence diminishes the good reputation of the profession and its ability to serve the public interest.
  - (b) With respect to Rule 102.1(e), in some cases a violation of tax legislation may be very technical in nature or may be the result of an unintentional oversight. In addition, there may be occasions when an aggressive tax filing position does not withstand a challenge by taxation authorities and is found by the courts to be in contravention of tax legislation. Such situations may not explicitly involve dishonesty but will require the exercise of professional judgement to decide whether they implicitly involve dishonesty and must be reported.
  - (c) Compliance with Rule 102.4 will also require the exercise of professional judgment to determine whether a breach of the requirements of another regulatory body is a matter that involves acting in a professional capacity, relates to professional skills, or involves reliance on membership in or association with any provincial Institute.
3. Members, students and firms faced with a decision as to whether a matter is reportable are expected to exercise professional judgment and to be prepared to demonstrate how professional judgment was exercised, should it later be called into question. Therefore, it would be prudent to obtain legal advice, document the rationale behind a decision that a matter need not be reported and, if doubt remains, report the matter to the Institute.
4. It is particularly important that the conduct of members, students and firms in a matter that involves

acting in a professional capacity, relates to professional skills, involves reliance on membership in or association with any provincial Institute or diminishes the good reputation of the profession and its ability to serve the public is subject to scrutiny. Accordingly, members, students and firms are required to report offences of fraud, theft, forgery, money-laundering, extortion, counterfeiting, criminal organization activities, charging criminal interest rates, financing terrorism and similar offences related to financial matters, including offences involving a violation of any of the provisions of securities legislation.

5. There may also be occasions when a criminal offence is of such a nature that the conduct of a member, student or firm has diminished the good reputation of the profession and its ability to serve the public interest, even though the offence may appear to be unrelated to the profession. Many such offences may still be serious and, accordingly, the member, student or firm should evaluate the breach against the requirements of the Rules and in particular, Rule 201.1. Any such matters which do not meet those requirements must also be reported to the Institute.
6. In addition, when a member, student or firm repeats a criminal offence that might not otherwise be reportable such repeat offences must also be reported to the Institute.
7. Members and firms may hold membership in or registration with more than one provincial institute. Students are ordinarily registered with only one provincial institute. In order to properly protect the public across jurisdictions, where a member or firm has been found guilty by or entered into a settlement agreement with one provincial institute, the member or firm must report that finding or settlement agreement to any other provincial institute in which the member holds membership or with which the firm is registered. In addition, some provincial institutes permit the resignation of members in order to resolve a disciplinary proceeding; in these cases, the member must also report such resignations to any other provincial institute in which membership is held.
8. Conduct which results in a breach of the requirements of another professional regulatory body is likely to diminish the good reputation of the profession or otherwise breach the Rules of Professional Conduct. Such breaches must be evaluated by the Institute against the requirements of the Rules and therefore, all such matters must be reported. Reporting of these matters is required whether they were addressed through a settlement agreement with or by a finding of guilt by the professional regulatory body.
9. Conduct which results in a breach of the requirements of any other regulatory body may also breach the Rules of Professional Conduct. In such situations, the member, student or firm should exercise professional judgment to determine whether such a breach is a matter that involves acting in a professional capacity, relates to professional skills, or involves reliance on membership in or association with any provincial Institute. The breach must be evaluated against the requirements of the Rules and in particular Rule 201.1, and any such matters which do not meet those requirements must be reported to the Institute. Reporting of these matters is required whether they were addressed through a settlement agreement with or by a finding of guilt by the other regulatory body.
10. A “regulatory body” is a quasi-judicial body that has power to compel a person to appear and answer to charges relating to compliance with its requirements. In this context, such a regulatory body’s requirements include legislation that it is empowered to enforce, whether against its own members or the public generally, codes of ethics, bylaws, regulations, professional or practice requirements and similar standards. Examples of regulatory bodies include, but are not limited to, competition, election, gaming, human rights, environmental protection and health and occupational safety bureaus, commissions and agencies.

11. A “professional regulatory body” is a quasi-judicial body that sets and maintains standards of qualification, attests to the competence of the individual practitioner, develops skills and standards of the profession, sets a code of ethical standards and enforces its professional and ethical standards. Such a body has power to compel a person to appear and answer to disciplinary actions relating to compliance with its standards. Examples of professional regulatory bodies include, but are not limited to, accounting, legal, actuarial, investment, real estate, engineering and financial planning professions.
12. In applying Rules 102.1 through 102.4, the words “guilt” and “guilty” include findings by a regulatory body of a contravention, breach, violation, infringement and other similar term in relation to failures to comply with its requirements. Additionally, the imposition of a requirement or restriction on a member or firm by a regulatory body is equivalent to “guilt”. However, administrative orders for penalties such as late filing penalties from tax assessments or reassessments or interim cease trade orders of a securities regulator do not constitute findings of guilt.
13. Members, students and firms are reminded that confidentiality agreements with respect to matters described in Rule 102.1 through 102.4 do not provide an exemption from the reporting requirements of these rules.

## **CI 201—GENERAL STANDARDS OF CONDUCT**

### **Criticism of a Member or Other Professional Colleague.**

1. During the course of his professional work, a member may on occasion find that he has a responsibility to criticize a member or other professional colleague; such criticism may be direct, or may be implied by material adjustments to a client's accounts considered necessary to correct work performed by the member or other professional colleague. It may be, however that there are facts or explanations known to the member or other professional colleague concerned which would have a bearing on the matter.
2. A member, unless limited or restricted in writing in special circumstances by the terms of his engagement, shall first submit any proposed criticism to the member or other professional colleague involved so that any eventual criticism takes into account all the available information. This is a step dictated by considerations both of professional courtesy and of simple prudence.
3. When a member does criticize a member or other professional colleague, and due to limitations or restrictions in writing by the terms of his engagement he has not been permitted to submit his criticism to the member or other professional colleague, the member should be on record with the person placing the restriction that such consultation has not taken place.

Refer also to Rule 306.

### **Selection of Professional Advisers**

4. When a client decides, for any reason, to change from one practitioner to another, the change should be facilitated on the basis of the following fundamental assumptions:
  - the clients' interests should be placed ahead of the personal interest of the member;
  - the client is free to have his work performed by the practitioner of his choice;

- the fee for professional services cannot be estimated until adequate information is available about the assignment;
- professional courtesy and cooperation should be maintained between members in complying with the client's wishes.

### **Responding to Requests by Prospective Clients**

5. When approached by a prospective client, a member may meet with him to discuss the proposed engagement and, subject to paragraphs 6 to 8 below, to evaluate the work required to carry out the assignment. The member approached should satisfy himself by suitable enquiry that he is aware of the position of any incumbent, and whether or not a decision to terminate an existing engagement has been made.
6. As the prospective client will wish to discuss with the member the services that may be needed or available, the member approached may provide the prospective client with information which will help him in making his selection. There is no objection to the member supplying such information and giving factual information as to his organization, the skills available therein and his per diem rates based on his standard rates for all clients. However, a member must not indicate or imply that he has exclusive knowledge or ability when in fact such knowledge or ability may be available from other practitioners.
7. The prospective client will also wish to obtain some indication of the cost of the services. Normally, professional fees are based on the time required to perform the services undertaken and a member discussing a possible assignment is rarely in a position to quote a fee or fee range until he has become more familiar with the requirements of the client, e.g. in an audit assignment he would need to familiarize himself with the prospective client's accounting policies and procedures and internal control, while in an accounting assignment he would be required to make an assessment of the prospective client's books and records and the application of his policies. Unless the member has so familiarized himself or made such an assessment, he cannot estimate the time required to carry out the professional responsibilities imposed by any statute or by the standards required by the profession, or by both.
8. Members are reminded that in accepting assignments from new clients they must comply with the requirements of Rules of Professional conduct 302 and 305, where applicable.

### **Resignation of Auditors**

9. On occasion, the question arises of the duty of a chartered accountant appointed to act as an auditor of a corporation, who is asked by the directors to resign before reporting.
10. In Company, Corporation and Business Corporation Acts the statutory provisions with regard to auditors form a very important part of the legislation. The whole background of corporation legislation makes it clear that the auditor fulfils an essential statutory and independent function and assumes statutory duties when he accepts his appointment. It is the Council's view that, as a general rule, the proper course for an appointed auditor to follow is the completion of his statutory duties; having been appointed by the shareholders he should report, as required in the legislation. He should lay down his duties only when a successor has been properly appointed, after he has been relieved or disqualified.

11. This being the proper course, the question remains whether there are exceptions when a duly authorized auditor may resign at the request of a board of directors without fulfilling his statutory duties. The answer depends on the circumstances. Certainly, the auditor of a company should not lightly resign under such circumstances, and should not resign at all, before reporting to the shareholders, if he has any reason to believe that his resignation is required by reason of any sharp practice, impropriety or concealment which it is his duty to report upon.
12. However, exceptional circumstances may exist in a particular case which would justify an auditor in acceding to a request for his resignation; one example would be where he has reason to believe that if a special meeting of the shareholders was called to relieve him of his appointment the necessary percentage of shareholders specified in the governing statute would require his resignation—in such a case it may not be necessary for the auditor to insist on a special meeting being called.
13. In summary, the auditor of a company is appointed to represent the shareholders and has a duty to them, he should never lightly resign his appointment before reporting and should not resign at all before reporting if he has reason to suspect that his resignation is required by reason of any sharp practice, impropriety or concealment, which it is his duty to report upon. Subject to that general statement, however, there may be exceptional circumstances in a particular case which would justify his resignation and this will be a matter of individual judgement in each case.

#### **Non-Member Public Accountants**

14. It is emphasized that the approaches outlined in this Interpretation are to be followed, where applicable, not only in dealing with fellow members and professional colleagues but in dealing with licensed public accountants generally.

Refer also to Rule 302.

#### **CI 202—INTEGRITY AND DUE CARE**

##### **Documentation**

1. Cases may arise from time to time where a member may be asked by a court, or by the Institute Council, to substantiate procedures carried out in the course of an assignment. If the member's files do not contain sufficient documentation to confirm the nature and extent of the work done, the member concerned may well have great difficulty in showing that proper procedures were in fact carried out. The importance of adequate documentation cannot be overemphasized; without it, a member's ability to outline and defend his professional work is seriously impaired.

#### **CI 203—SUSTAINING PROFESSIONAL COMPETENCE**

*Generally accepted standards of practice of the profession*

1. Compliance with Rule 203 necessarily requires that a member keep informed of and comply with generally accepted standards of practice of the profession in all functions in which the member practises or is relied upon because of the member's calling. For the purposes of Rule 203,

generally accepted standards of practice of the profession include, but are not limited to the following:

- (a) the standards and guidance contained in the *CICA Handbook*;
- (b) the standards of practice or Standard Practices adopted by a CICA Alliance for Excellence;
- (c) the governing legislation, bylaws, regulations and rules of professional conduct of the provincial institute(s) to which the member belongs; and
- (d) requirements of relevant federal and provincial statutes.

*Compliance with rules of professional conduct when performing a specialist engagement*

2. Without limiting the generality of paragraph 1(c) of this Council interpretation,
  - (a) a member or firm performing any specialist engagement must comply with Rule 202.1 -- Integrity and Due Care and Rule 202.2 – Objectivity;
  - (b) a member who or firm that improperly claims specialist status or designation as a specialist may violate one or more of the following Rules of Professional Conduct:
    - Rule 201.1 – Maintenance of the reputation of the profession;
    - Rule 202.1 -- Integrity and due care;
    - Rule 210 -- Conflict of interest; and
    - Rule 217.1(a) – Advertising and solicitation;
  - (c) a member who is designated as a specialist by the appropriate CICA Alliance for Excellence and the Institute or who designates himself or herself as a specialist shall comply with any standards of practice or Standard Practices of the applicable CICA Alliance for Excellence;
  - (d) a member or firm performing an assurance or specified auditing procedures engagement that is a component part of an investigative and forensic accounting engagement must comply with the rules of professional conduct of the Institute in respect of the assurance or specified auditing procedures component of the engagement;
  - (e) a member or firm performing an investigative or forensic accounting engagement that is a component part of an assurance or specified auditing procedures engagement must comply with the rules of professional conduct of the Institute in respect of the investigative and forensic accounting component of the engagement, and, in particular, the provisions of Rule 204.
3. “Investigative and forensic accounting engagements” are defined in the Standard Practices adopted by the CICA Alliance for Excellence in Investigative and Forensic Accounting as requiring the application of professional accounting skills, investigative skills, and an investigative mindset that are also required to perform an assurance or specified auditing procedures engagement. However, members and firms are advised that the Standard Practices do not apply to assurance or specified auditing procedures engagements. Members and firms performing assurance or specified auditing procedures engagements are required to comply with the standards set out in the *CICA Handbook – Assurance* and with the rules of professional conduct of the Institute in respect of the engagement, including when an assurance or specified auditing procedures engagement is a component part of an investigative and forensic accounting engagement.
4. Where a conflict arises between any applicable standards of practice or Standard Practices and the Rules of Professional Conduct, members and firms should observe the higher or stronger of the conflicting requirements and, where that is not possible, refer to the ethical conflict guidance set out in the Foreword to the Rules.

5. Individuals who have earned the designation “Chartered Accountant” have demonstrated a high level of education and professional experience. To hold oneself out as a specialist is to imply possession of additional advanced skills, competencies and experience in a particular field.
6. Specialization must be distinguished from expertise. Expertise implies extraordinary knowledge about a specific subject - no matter how broad or how narrow. Specialization implies a concentration of professional skills and competencies developed and applied over a meaningful period of time. A person may be an expert without being a specialist.
7. Members designating themselves, their practising offices or related function businesses or practices as specialists must be prepared to substantiate the claim. Failure to provide advice to a specialist standard after accepting an engagement to do so may have serious legal consequences.
8. A member seeking identification as a specialist should be designated as a specialist by the appropriate CICA Alliance For Excellence or Accredited Organization or should meet the following minimum criteria:
  - (a) the member should be recognized as such by peers, clients and business associates;
  - (b) a significant percentage of the member’s time over a sustained period should have been spent in the specialty;
  - (c) where applicable, the member should have completed courses and/or successfully completed appropriate examinations for the specialty;
  - (d) the member should continue professional development relevant to the specialty, such as attendance at courses, teaching or writing; and
  - (e) the member should continue to devote a significant percentage of time to the specialty.

## **CI 204—INDEPENDENCE**

### **COUNCIL INTERPRETATIONS TO RULES 204.1 TO 204.6**

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#### **INTRODUCTION**

1. It is a fundamental principle of the practice of Chartered Accountancy that a member who provides assurance services shall do so with unimpaired professional judgment and objectivity, and shall be seen to be doing so by a reasonable observer. This principle is the foundation for public confidence in the reports of assurance providers.
2. The confidence that professional judgment has been exercised depends on the unbiased and objective state of mind of the reporting accountant, both in fact and appearance. Independence is the condition of mind and circumstance that would reasonably be expected to result in the application by a member of unbiased judgment and objective consideration in arriving at opinions or decisions in support of the member's report.
3. Rule 204.1 provides that a member or firm who engages or participates in an engagement:
  - (a) to issue a written communication under the terms of any assurance engagement; or
  - (b) to issue a report on the results of applying specified auditing procedures;
 must be independent of the client. Independence requires the avoidance of situations which impair the professional judgment or objectivity of the member, firm or a member of the firm or which, in the view of a reasonable observer, would impair that professional judgment or objectivity.

4. Rule 204.2 provides that a member or firm, who is required to be independent pursuant to Rule 204.1 in respect of a particular engagement, must identify and evaluate threats to independence and, if they are not clearly insignificant, identify and apply safeguards to reduce them to an acceptable level. Where safeguards are not available to reduce the threats to an acceptable level the member or firm must eliminate the activity, interest or relationship creating the threats, or refuse to accept or continue the engagement. Rule 204.3 requires the member or firm to document compliance with Rule 204.2.
5. Rule 204.4 describes circumstances and activities which members and firms must avoid when performing assurance and specified auditing procedure engagements because adequate safeguards will not exist that will, in the view of a reasonable observer, eliminate the threat or reduce it to an acceptable level, as required by Rule 204.2. The requirements to avoid these circumstances and activities are referred to as “prohibitions.”
6. Rule 204.5 provides that a member or student must disclose breaches of the Rule to a designated partner in the firm. It also provides that, when a member or student has been assigned to an engagement team, the member or student must disclose to a designated partner any interest, relationship or activity that would preclude the member or student from being on the engagement team.
7. Rule 204.6 provides that a firm must ensure that members of the firm comply with Rule 204.4. The Rule provides that a firm shall not permit a member of the firm to have a relationship with or an interest in an assurance client, or provide a service to an assurance client, which is precluded by Rule 204.
8. This Council Interpretation describes a conceptual framework of principles that members and firms should use to identify threats to independence and evaluate their significance. If the threats are other than clearly insignificant, the member or firm should identify available safeguards. Some safeguards may already exist within the structure of the firm or the client, while others may be created by the action of the member, firm or client. Safeguards should be identified and, where applicable, applied to eliminate the threats or reduce them to an acceptable level. Members should exercise professional judgment to determine which safeguards to apply and whether the safeguards will permit the member or firm to accept or continue the engagement.
9. The effectiveness of safeguards largely depends on the culture of the particular firm. Therefore, the Council encourages leaders of firms to stress the importance of compliance with Rule 204 and emphasize the expectation that members of the firm will act in the public interest. In doing so, firms should create and monitor effective policies and procedures designed to preserve the independence of the firm and its partners and employees when required by Rule 204.
10. The examples presented herein are intended to illustrate the application of the principles; they are not, nor should they be interpreted as, an exhaustive list of all circumstances that may create a threat to independence. Consequently, it is not sufficient for a member or a firm merely to comply with the examples presented. Rule 204.2 requires that they apply the principles to any particular circumstance encountered, whether or not the examples used in the Council Interpretation, or the prohibitions set out in Rule 204.4, reflect those circumstances.
11. These examples describe specific circumstances and relationships that may create threats to independence. They also describe the safeguards that may be appropriate to eliminate

the threats or reduce them to an acceptable level in each circumstance. While the examples relate to the audit or review of financial statements and other assurance engagements, they also apply to engagements to issue a report on the results of applying specified auditing procedures as required by Rule 204.1(b).

12. This Council Interpretation sets out how, in the Council's opinion, a reasonable observer might view certain situations in the application of Rule 204.1 to 204.6. The reasonable observer is a hypothetical individual who has knowledge of the facts which the member knew or ought to have known, including the safeguards applied, and who applies judgment objectively, with integrity and due care. Members should also refer to the Foreword to the Rules, which provides the rationale for establishing the reasonable observer principle.
13. Members are reminded that for the purposes of Rules 204.1 to 204.6, independence includes both independence of mind and independence in appearance. As stated in Rule 204.1, independence requires the absence of any influence, interest or relationship which would impair the professional judgment or objectivity of the member or a member of the firm or which, in the view of a reasonable observer, would impair the professional judgment or objectivity of the member or a member of the firm. Frequently it is appearance of independence, or lack thereof, that poses the greatest challenge. In all situations, members should reflect on the wording of the Rule and Council Interpretation to ensure compliance with the spirit and intent of the Rule and Council Interpretation.
14. If, after considering the rules and this Council Interpretation, members are uncertain as to their correct application, they are encouraged to discuss the matter with partners, professional colleagues or Institute staff.
15. Members should also be cognizant of any relevant Canadian or foreign legislation that may preclude a member from accepting or continuing an engagement. Members are cautioned that legislation under which corporations and other enterprises are incorporated or governed may impose differing requirements in respect of independence. Members should satisfy both the requirements of any governing legislation and these Rules of Professional Conduct.
16. Members and firms are reminded that Rules 204.7 and 204.8 deal respectively with independence standards for insolvency engagements and the requirement to disclose when the appearance of independence may be lacking in other engagements.

## **THE FRAMEWORK**

17. The objective of this Council Interpretation is to assist members and firms in:
  - (a) identifying and evaluating threats to independence; and
  - (b) identifying and applying appropriate safeguards to eliminate or reduce the threat or threats to an acceptable level in instances where their cumulative effect is not clearly insignificant.

This Council Interpretation also describes those situations referred to in Rule 204.4 where safeguards are not available to reduce a threat or threats to an acceptable level, and the only possible actions are to eliminate the activity, interest or relationship creating them, or to refuse to accept or continue the assurance engagement.
18. The use of the word "independence" on its own may create misunderstandings. Standing alone, the word may suggest that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as everyone

has relationships with others. Therefore, members should evaluate the significance of economic, financial and other relationships in the light of what a reasonable observer would conclude to be acceptable in maintaining independence.

19. In making this evaluation, many different circumstances may be relevant. Accordingly, it is impossible to define every situation that creates a threat to independence and specify the appropriate mitigating action. In addition, because of differences in the size and structure of firms, the nature of assurance engagements and client entities different threats may exist, that require the application of different safeguards. A conceptual framework that requires members and firms to identify, evaluate and address threats to independence, rather than merely comply with a set of specific and perhaps arbitrary rules, is, therefore, in the public interest.
20. Based on such an approach, this Council Interpretation describes a conceptual framework of principles for compliance with Rules 204.1 to 204.6. Members, firms and network firms should use this conceptual framework to identify threats to independence, to evaluate their significance and, if they are other than clearly insignificant, to identify and apply safeguards to eliminate them or reduce them to an acceptable level, so that independence of fact and appearance are not impaired. In addition, consideration should be given to whether relationships between members of the firm who are not on the engagement team and the assurance client may also create threats to independence. Where safeguards are not available to reduce threats to an acceptable level, the member, firm or network firm should eliminate the activity, interest or relationship creating the threats, or the member or firm should refuse to accept or continue the particular engagement.
21. Rule 204.1 requires members and firms to be independent in fact and in appearance. The requirement to comply with the specific prohibitions set out in Rule 204.4 does not relieve a firm from complying with Rules 204.1 and 204.2 and the need to apply the conceptual framework and determine on a principles-based approach whether or not the firm is independent with respect to all assurance engagements, including audit and review engagements.
22. Rule 204.1 and therefore, the principles in this Council Interpretation apply to all assurance engagements and engagements to issue a report on the results of applying specified auditing procedures. The nature of the threats to independence and the applicable safeguards necessary to eliminate them or reduce them to an acceptable level will differ depending on the particulars of the engagement. Differences in threats and safeguards will arise, for example, if the engagement is an audit or review engagement or another type of assurance engagement; and, in the case of an assurance engagement that is not an audit or review engagement, in the purpose, subject matter and intended users of the report. Members and firms should, therefore, evaluate the relevant circumstances, the nature of the engagement and the entity, the threats to independence and the adequacy of available safeguards in deciding whether it is appropriate to accept or continue an engagement, and whether a particular person should be on the engagement team.
23. For audit clients and review clients, the persons on the engagement team, the firm and network firms should be independent of the client. In the case of an assurance engagement where the client is neither an audit nor a review client, those on the engagement team and

the firm should be independent of the client. In addition, in the case of an engagement that is not an audit or review engagement, consideration should be given to any threats the firm has reason to believe may be created by the interests and relationships of network firms.

24. The term “firm” means a sole practitioner, partnership or association of members who carries or carry on the practice of public accounting, or carries or carry on related activities as defined by the Council. A related activity includes a related business or practice that is cross-referenced with a practice of public accounting or with any other business or practice which is cross-referenced with a practice of public accounting in accordance with Rule 420. In those jurisdictions where a member or a firm may practice in a corporate form, firm includes a professional corporation.
25. The term “network firm” means an entity under common control, ownership or management with a firm or an entity that a reasonable observer who has knowledge of the facts would conclude to be part of the firm nationally or internationally. The term “network firm” does not, however, include a related business or practice, as defined, in Canada.
26. The references to “firms” and “network firms” in Rules 204.1 to 204.6 and this Council Interpretation should be read as referring to those entities themselves and not to the persons who are partners or employees thereof.
27. An engagement to report on the results of applying specified auditing procedures is not an assurance engagement as contemplated in the *CICA Handbook — Assurance*. However, for the purposes of Rules 204.1 to 204.6 and this Council Interpretation, the principles contained herein applicable to an assurance engagement, other than an audit or review engagement, also apply to an engagement to report on the results of applying specified auditing procedures. In so applying those principles, the reference to an assurance client is to be read as a reference to a client where the engagement is to report on the results of applying specified auditing procedures.
28. In the case of an assurance report to an assurance client that is not an audit client or a review client where the report is intended only for the use of identified users, as contemplated by “Standards for Assurance Engagements,” Section 5025 of the *CICA Handbook — Assurance*, the users of the report are considered to be knowledgeable as to the purpose, subject matter and limitations of the report. Users gain such knowledge through their participation in establishing the nature and scope of the member’s or firm’s engagement, including the criteria by which the particular subject matter is to be evaluated. The member’s or firm’s knowledge and enhanced ability to communicate about safeguards with all the report’s users increase the effectiveness of safeguards to independence in appearance. Therefore, the member or firm may take these circumstances into account when evaluating the threats to independence and considering the applicable safeguards necessary to eliminate them or reduce them to an acceptable level. With respect to network firms, limited consideration of any threats created by their interests and relationships may be sufficient.
29. The effect of Rules 204.1 to 204.6 is that:

- (a) For an assurance engagement for a client that is an audit or review client, those on the engagement team, the firm and network firms are required to be independent of the client.
  - (b) For an assurance engagement for a client that is not an audit or review client, when the assurance report is not intended only for the use of identified users, those on the engagement team and the firm are required to be independent of the client.
  - (c) For an assurance engagement for a client that is not an audit or review client, when the assurance report is intended only for the use of identified users, those on the engagement team are required to be independent of the client. In addition, the firm should not have a material direct or indirect financial interest in the client.
30. The threats and safeguards identified in this Council Interpretation are generally discussed in the context of interests or relationships between the firm, a network firm, those on the engagement team and the assurance client. In the case of an audit or review client the prohibitions with respect to financial interests are extended to related entity of the client and in the case of an audit client that is a listed entity, the prohibitions with respect the provision of non-assurance services are extended to related entities of the audit client. For assurance clients other than audit and review clients, when the engagement team has reason to believe that a related entity of the client is relevant to the evaluation of the firm's independence, the engagement team should consider that related entity when evaluating threats to independence and applying appropriate safeguards.
31. For the purposes of Rules 204.1 to 204.6 a related entity of a client that is a reporting issuer means:
- an entity that has control over a client;
  - an entity over which the client has control;
  - an entity in which is under common control with the client;
  - an entity over which the client has significant influence, unless the entity is not material to the client; and
  - an entity which has significant influence over the client, unless the client is not material to the entity.

The definition of a related entity for a client that is not a reporting issuer excludes from the above an entity that has control over the client if the client is not material to the entity, and entity under common control with the client if both the client and the entity under common control are not material to the entity that controls them.

32. For the purposes of Rules 204.1 to 204.6 a related entity of a client means an affiliate of the client and an entity over which the client has significant influence, unless the entity is not material to the client, and an entity which has significant influence over the client, unless the client is not material to the entity. In determining whether significant influence exists members should follow the guidance established in "Long-Term Investments," Section 3050 of the *CICA Handbook — Accounting*. Ideally, the client's related entities and the interests and relationships that involve the related entities should be identified in advance.
33. A retired partner who retains a close association with the firm from which the partner has retired is considered to be a member of the firm for the purposes of Rules 204.1 to 204.6

and the related Council Interpretation. Retired partners may have varying degrees of involvement with the firm. When a retired partner continues to provide administrative or client service for or on behalf of the firm, the partner may be closely associated with the firm. The following factors may indicate that the partner retains a close association with the firm:

- the nature and extent of the retired partner's client and administrative activities within the firm may be more than clearly insignificant and transitional;
- the retired partner holds a direct or indirect financial interest in the firm, including share-based retirement income that may fluctuate with the firm's income; and
- the retired partner is held out to be a member of the firm through, for example, having a separate, identified office on the firm's premises, acting as its spokesperson or representative, using a firm business card or having a listing in the firm's telephone directory for other than a predetermined period of time following retirement.

When evaluating whether a retired partner has a close association with the firm, consideration should be given to how a reasonable observer would regard the association.

34. Rules 204.1 to 204.4 and this Council Interpretation bring the independence of a network firm into consideration when evaluating the independence of a member or firm for an audit or review engagement. It is the member's or firm's responsibility to determine whether the network firm and its members have any interests or relationships or provide any services that would create threats to independence.
35. The ongoing evaluation and disposition of threats to independence should be supported by evidence obtained both before accepting an engagement and while it is being performed. The obligation to make such evaluation and take action arises when a member of a firm or network firm knows, or should reasonably be expected to know, of circumstances or relationships that might impair independence. There may be occasions when a member, a firm or a network firm is inadvertently in breach of the principles in this Council Interpretation. If such an inadvertent breach occurs, it would generally not impair independence for the purposes of Rules 204.1 to 204.6, provided the firm had appropriate quality control policies and procedures in place to promote independence and, once discovered, the breach was corrected promptly and any necessary safeguards were applied. An inadvertent breach would include a situation where the member did not know of the circumstances that created the breach.
36. Rules 204.1 to 204.6 and this Council Interpretation describe the threats to independence and analyzes safeguards that may be capable of eliminating them or reducing them to an acceptable level. It concludes with some examples of how this conceptual framework to independence is to be applied to specific circumstances and relationships and the relevant threats and safeguards. The examples are not all inclusive. Professional judgment should be used to determine whether appropriate safeguards exist to eliminate all threats to independence or to reduce their cumulative effect to an acceptable level. In some examples, it may be possible to eliminate the threat or reduce it to an acceptable level by the application of safeguards. In some other examples, the threat or threats to independence will be so significant that the only possible actions are to eliminate the activity, interest or relationship creating the threat or threats, or to refuse to accept or continue the engagement.
37. When a member or firm identifies a threat to independence that is not clearly insignificant, and the member or firm decides to apply appropriate safeguards and accepts or continues the assurance engagement, the decision should be documented in accordance with Rule 204.3. The documentation should include the following information:
  - (a) a description of the nature of the engagement;
  - (b) the threat identified;

- (c) the safeguard or safeguards identified and applied to eliminate the threat or reduce it to an acceptable level; and
  - (d) an explanation of how, in the member or firm's professional judgment, the safeguards eliminate the threat or reduce it to an acceptable level.
38. Throughout this Council Interpretation, reference is made to "significant" and "clearly insignificant." In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is both trivial and inconsequential.

## **THREATS TO INDEPENDENCE**

39. Independence is potentially affected by self-interest, self-review, advocacy, familiarity and intimidation threats. The mere existence of such threats does not *per se* mean that the performance of a prospective engagement is precluded. The undertaking or continuation of engagement is only precluded where safeguards are not available to eliminate or reduce the threats to an acceptable level or where Rule 204.4 provides a specific prohibition.
40. A **Self-Interest Threat** occurs when a firm or a person on the engagement team could benefit from a financial interest in, or other self-interest conflict with, an assurance client. Examples of circumstances that may create a self-interest threat include, but are not limited to:
- (a) a direct financial interest or material indirect financial interest in an assurance client;
  - (b) a loan or guarantee to or from an assurance client or any of its directors or officers;
  - (c) dependence by a firm, office or member on total fees from an assurance client;
  - (d) undue concern about the possibility of losing the engagement;
  - (e) compensating an audit partner for selling non-audit services to an audit client;
  - (f) having a close business relationship with an assurance client; and
  - (g) potential employment with an assurance client.
41. A **Self-Review Threat** occurs when any product or judgment from a previous engagement needs to be evaluated in reaching conclusions on the particular assurance engagement, or when a person on the engagement team was previously a director or officer of the client, or was an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement.
- Examples of circumstances that may create a self-review threat include, but are not limited to:
- (a) a person on the engagement team being, or having recently been, a director or officer of the client;
  - (b) a person on the engagement team being, or having recently been, an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the engagement;
  - (c) a member or firm performing services for an assurance client that directly affect the subject matter of the engagement; and
  - (d) a member or firm preparing original data used to generate financial statements or preparing other records that are the subject matter of the engagement.
42. An **Advocacy Threat** occurs when a firm, or a person on the engagement team, promotes, or may be perceived to promote, an assurance client's position or opinion to the point that objectivity may be, or may be perceived to be, impaired. Such would be the case if a person on the engagement team was to subordinate his or her judgment to that of the client,

or the firm was to do so. Examples of circumstances that may create an advocacy threat include, but are not limited to:

- (a) dealing in, or being a promoter of, shares or other securities of an assurance client; and
- (b) acting as an advocate on behalf of an assurance client in litigation or in resolving disputes with third parties.

43. A **Familiarity Threat** occurs when, by virtue of a close relationship with an assurance client, its directors, officers or employees, a firm or a person on the engagement team becomes too sympathetic to the client's interests. Examples of circumstances that may create a familiarity threat include, but are not limited to:
- (a) a person on the engagement team having an immediate or close family member who is director or officer of the assurance client;
  - (b) a person on the engagement team having an immediate or close family member who, as an employee or shareholder of the assurance client, is in a position to exert direct and significant influence over the subject matter of the assurance engagement;
  - (c) a former partner of the firm being a director, officer or employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement;
  - (d) the long association of a senior person on the engagement team with the assurance client; and
  - (e) the acceptance of gifts or hospitality from the assurance client, its directors, officers or employees, unless the value thereof is clearly insignificant.
44. An **Intimidation Threat** occurs when a person on the engagement team may be deterred from acting objectively and exercising professional skepticism by threats, actual or perceived, from the directors, officers or employees of an assurance client. Examples of circumstances that may create an intimidation threat include, but are not limited to:
- (a) the threat of being replaced due to a disagreement with the application of an accounting principle; and
  - (b) the application of pressure to inappropriately reduce the extent of work performed in order to reduce or limit fees.

## **SAFEGUARDS**

45. Members and firms have an ongoing responsibility to comply with Rules 204.1 to 204.6 by taking into account the context in which they practise, the threats to independence and the safeguards which may be available to eliminate the threats or reduce them to an acceptable level. Safeguards fall into three broad categories:
- (a) safeguards created by the profession, legislation or regulation;
  - (b) safeguards within the assurance client; and
  - (c) safeguards within the firm's own systems and procedures.
46. Safeguards created by the profession, legislation or regulation include the following:
- (a) education, training and practical experience requirements for entry into the profession;
  - (b) continuing education programs;
  - (c) professional standards;
  - (d) external practice inspection;
  - (e) disciplinary processes;
  - (f) members' practice advisory services;
  - (g) participation by members of the public in oversight and governance of the profession; and
  - (h) legislation governing the independence requirements of the firm and its members.

47. Safeguards within the assurance client may include the following:
- (a) employees of the client who are competent to make management decisions;
  - (b) policies and procedures that emphasize the client's commitment to fair financial reporting;
  - (c) internal procedures that ensure objective choices in commissioning non-assurance engagements; and
  - (d) an audit committee that provides appropriate oversight and communications regarding a firm's services.
48. When audit committees are independent of client management they can have an important corporate governance role and can assist the board of directors in satisfying themselves that a member or a firm is independent in carrying out its audit role. Annual communication with the audit committee on matters relating to independence is required by "Communications With Those Having Oversight Responsibility for the Financial Reporting Process," Section 5751 of the *L704 Handbook — Assurance*.
49. Firms should establish policies and procedures for independence-related communications with audit committees. In the case of an audit client, the firm should communicate orally and in writing, at least annually, all relationships and other matters between the firm, network firms and the client that in the firm's professional judgment may reasonably be thought to bear on independence. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out herein.
50. Safeguards within the firm's own systems and procedures may include firm-wide safeguards such as the following:
- (a) firm leadership that stresses the importance of independence and the expectation that persons on engagement teams will act in the public interest;
  - (b) policies and procedures to implement and monitor quality control of assurance engagements;
  - (c) documented independence policies regarding the identification of threats to independence, the evaluation of their significance and the identification and application of appropriate safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level;
  - (d) internal policies and procedures, including annual reporting by members of the firm, to monitor compliance with firm policies and procedures as they relate to independence;
  - (e) policies and procedures that will enable the identification of interests or relationships between the firm or those on the engagement team and assurance clients;
  - (f) policies and procedures to monitor and manage the reliance on revenue received from a single assurance client;
  - (g) internal performance measures that do not put excessive pressure on partners to generate non-assurance revenue from their assurance clients and do not over emphasize budgeted hours;
  - (h) using different partners and teams with separate reporting lines for the provision of non-assurance services to an assurance client;
  - (i) policies and procedures to prohibit members of the firm who are not on the engagement team from influencing the outcome of the assurance engagement;
  - (l) timely communication of a firm's policies and procedures, and any changes thereto, to all members of the firm, including appropriate training and education thereon;
  - (k) designating a member of the firm's senior management as responsible for overseeing the adequate functioning of the safeguarding system;
  - (l) means of advising all members of the firm of those clients and related entities from which they should be independent;

- (m) an internal disciplinary mechanism to promote compliance with firm policies and procedures; and
  - (n) policies and procedures that empower members of the firm to communicate, without fear of retribution, to senior levels within the firm any issue of independence and objectivity that may concern them.
51. Safeguards within the firm's own systems and procedures may include engagement-specific safeguards such as the following:
- (a) involving another person to review the work done or advise as necessary. This person could be someone from outside the firm or network firm, or someone from within who was not otherwise associated with the engagement team. The person should be independent of the assurance client and will not, by reason of the review performed or advice given, be considered to be on the engagement team;
  - (b) consulting a third party, such as a committee of independent directors, a professional regulatory body or a professional colleague;
  - (c) rotating senior personnel on the engagement team;
  - (d) discussing independence issues with the audit committee;
  - (e) disclosing to the audit committee, the nature of services provided and extent of fees charged;
  - (f) policies and procedures designed to ensure that persons on the engagement team do not make, or assume responsibility for, management decisions for the client;
  - (g) involving another firm to perform or re-perform part of the assurance engagement;
  - (h) involving another firm to re-perform the non-assurance service; and
  - (i) removing a person from the engagement team, when that person's financial interests, relationships or activities create a threat to independence.

### **Practitioners with Small or Owner-Managed Clients**

52. The size and structure of the firm and the nature of the assurance client and the engagement will affect the type and degree of the threats to independence and, consequently, the types of safeguards appropriate to eliminate such threats or reduce them to an acceptable level. For example, it is understood that not all the safeguards noted in paragraphs 47 - 51 will be available to the sole practitioner or small firm or within smaller clients such as owner-managed entities. Smaller clients often rely on members to provide a broad range of accounting and business services. Independence will not be impaired provided such services are not specifically prohibited by Rule 204.4 and provided safeguards are applied to reduce any threat to an acceptable level. In many circumstances, explaining the result of the service and obtaining client approval and acceptance for the result of the service will be an appropriate safeguard for such smaller entities. Similarly, such clients often have a long-standing relationship with an individual who is a sole practitioner or partner from a firm. Independence will not be impaired provided safeguards are applied to reduce any familiarity threat to an acceptable level. In most circumstances, periodic external practice inspection and, where appropriate, consultation will reduce any threat to independence to an acceptable level.

### **ENGAGEMENT PERIOD**

53. The firm and those on the engagement team should be independent of the assurance client during the period of the assurance engagement. This period starts when the member or firm engages to perform the assurance service and ends when the assurance report is issued, except when the engagement is of a recurring nature. If the assurance engagement is

expected to recur, the engagement period ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later. In the case of an audit engagement for a listed entity the engagement period ends when the audit client or the firm notifies the relevant Securities Commission that the audit client is no longer an audit client of the firm.

54. In the case of an audit or review engagement, independence is also required during the period covered by the financial statements reported on by the member or firm. When an entity becomes an audit or review client during or after the period covered by the financial statements that the member or firm will report on, the member or firm should consider whether any threats to independence may be created by:
- (a) financial or business relationships with the client during or after the period covered by the financial statements, but prior to the acceptance of the engagement; or
  - (b) previous services provided to the client.
- Similarly, in the case of an assurance engagement that is not an audit or review engagement, the member or firm should consider whether any financial or business relationships or previous services may create threats to independence.
55. If a non-assurance service was provided to an audit or review client during or after the period covered by the financial statements but before the commencement of professional services in connection with the audit or review engagement, and the non-assurance service would impair independence if it had been provided during the period of the audit or review engagement, consideration should be given to the threats to independence, if any, arising from the provision of the non-assurance service. If a threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:
- (a) discussing independence issues related to the provision of the non-assurance service with the audit committee;
  - (b) requiring the client to review and accept responsibility for the results of the non-assurance service;
  - (c) precluding personnel who provided the non-assurance service from participating in the audit or review engagement; and
  - (d) engaging another firm to review the results of the non-assurance service or having another firm re-perform that service.
- If adequate safeguards are not available to reduce a threat to an acceptable level, the member or firm should decline the audit or review engagement.

## **LISTED ENTITIES**

56. A non-assurance service provided to an audit client that is not a listed entity would not impair the firm's independence when the client becomes a listed entity, provided:
- (a) the previous non-assurance service was not prohibited by Rule 204.4 for an audit client that is not a listed entity; and
  - (b) the firm had implemented appropriate safeguards to eliminate or reduce to an acceptable level any threats to independence arising from the previous service.
57. For the purposes of Rule 204.4 an entity becomes a listed entity by virtue having market capitalization or total assets in excess of \$10,000,000. In the case of a period in which an entity makes a public offering, market capitalization is measured at the closing price on the day of the public offering and total assets refers to the total assets presented on the most recent financial statements, prepared in accordance with generally accepted accounting principles, that are included in the offering document.

58. When an entity becomes a listed entity by virtue of a public offering, the auditor of the entity is required, from that period forward until the entity ceases to be a listed entity, to comply with the specific prohibitions contained in Rule 204.4 that relate to an audit of a listed entity. For example, bookkeeping services may not be provided following the date of an initial public offering where the market capitalization or total assets of the entity exceed \$10,000,000. The provision of bookkeeping services to the entity prior that date would not impair the firm's independence provided the services were not prohibited by Rule 204.4(23) and provided the firm had implemented appropriate safeguards to eliminate, or reduce to an acceptable level, any threats to independence arising from the provision of the services. Such safeguards might include:
- discussing the matter with the audit committee; or
  - involving an additional member of the firm who is not, and never was, on the engagement team to advise on the impact of the bookkeeping services provided on the independence of the persons on the engagement team and the firm.

## **APPLICATION OF THE FRAMEWORK**

59. The following examples describe the application of the framework to specific circumstances and relationships that may create threats to independence. The examples describe potential threats created and safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level. The examples are not intended to be comprehensive or all-inclusive. In practice, when independence is required, members and firms should assess the implications of all circumstances and relationships and, where required, assess those of network firms, to determine whether there are threats to independence that are other than clearly insignificant and, if they exist, whether safeguards can be applied to satisfactorily address them. In situations where safeguards are not available to reduce a threat or threats to an acceptable level, the only possible actions are to eliminate the activity, interest or relationship creating the threats, or to refuse to accept or continue the assurance engagement.
60. A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, whether that interest is material and whether it is direct or indirect.
61. When evaluating whether a financial interest is direct or indirect, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g., a mutual fund or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions of the entity in which the particular financial interest exists. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or the intermediary's investment strategy. When control exists, the financial interest should be considered direct. Conversely, when control does not exist the financial interest should be considered indirect.
62. In the application of Rules 204.4(1) to (12) to an audit or review client the reference to an assurance client, a client or an entity includes related entities, as defined, of the assurance client, client or entity, as the case may be.

## Assurance clients

63. Rule 204.4(1) provides that a member or student who participates on an engagement team for an assurance client, including an audit or review client, and the member's or student's immediate family may not hold a direct financial interest or a material indirect financial interest in the assurance client.
64. A reasonable observer will not view a member who holds a direct financial interest or material indirect financial interest as a trustee differently than someone who holds the interest beneficially. Accordingly Rule 204.4(1) applies to members, students and immediate family of members or students who hold a direct financial interest or material indirect financial interest in the capacity of a trustee.
65. When a person on an engagement team, or any of the person's immediate family, receives, for example, by way of gift or inheritance or as a result of a merger or reorganization, a direct financial interest or a material indirect financial interest in a particular assurance client, or a related entity of the client in the case of an assurance client that is an audit or review client, one of the following actions should be taken to comply with Rule 204.4(1):
- dispose of the financial interest at the earliest practical date but no later than 30 days after the person has knowledge of the financial interest and the right or ability to dispose of it; or
  - remove the person from the engagement team.
- During the period prior to disposal of the financial interest or the removal of the person from the engagement team, consideration should be given to whether additional safeguards are necessary to reduce the threat to independence to an acceptable level. Such safeguards might include:
- discussing the matter with the audit committee; or
  - involving another member of the firm who is not, and has not been, on the engagement team to review the work done by the person, or advise as necessary.
- Members are reminded that Rule 204.5 requires a member who has an interest that is precluded by this Rule to advise in writing a designated partner of the firm of the interest.
66. When a person on an engagement team knows that a close family member has a direct financial interest or a material indirect financial interest in the particular assurance client, or a related entity of the client in the case of an assurance client that is an audit or review client, a self-interest threat may exist. In evaluating the significance of any such threat, consideration should be given to the nature of the relationship between the person on the engagement team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be applied. Such safeguards might include:
- the close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;
  - discussing the matter with the audit committee;
  - involving another member of the firm who is not, and never was, on the engagement team to review the work done by the particular person on the engagement team or advise as necessary; or
  - removing the person from the engagement team.
67. Consideration should be given to whether a self-interest threat may exist because of the financial interests of individuals other than those on the engagement team and their immediate and close

family. Such individuals would include:

- a member of the firm who provides a non-assurance service to the assurance client;
- a member of the firm who has a close personal relationship with a person on the engagement team;
- a spouse or dependant of an immediate or close family member of a person on the engagement team; and
- an individual for whom a member of the engagement team holds power of attorney

Whether the interests held by such individuals may create a self-interest threat will depend upon

factors such as:

- the firm's organizational, operating and reporting structure;
- the nature of the relationship between the individual and the person on the engagement team; and
- in the case of a power of attorney, the degree of decision making power granted by the power of attorney

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:

- where appropriate, policies to prohibit such individuals from holding such interests;
- discussing the matter with the audit committee; or
- involving another member of the firm who is not, and never was, on the engagement team to review the work done by the particular individual or advise as necessary.

#### **A. FINANCIAL INTERESTS**

68. Subject to Rule 204.4(7) relating to an audit or review engagement, the specific prohibitions of Rule 204.4 do not preclude a firm from accepting an assurance engagement with an entity if one or more partners of the firm who do not participate on the engagement team, and who do not practice in the same office as the lead engagement partner, have a financial interest in the entity. However, Rule 204.1 requires the firm to be independent in fact and appearance and requires the firm to identify threats to independence arising from such circumstances, evaluate the significance of the threats and, if they are other than clearly insignificant, apply safeguards to reduce the threats to an acceptable level. If adequate safeguards are not available the firm should not accept the engagement.

69. An inadvertent breach of the principles in this Council Interpretation as they relate to a financial interest in an assurance client, or a related entity of the client in the case of an assurance client that is an audit or review client, would not impair the independence of the member of the firm or the firm when:

- the firm has established policies and procedures that require a network firm and all members of the firm to report promptly any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;
- the firm promptly notifies the network firm or the member of the firm that the financial interest should be disposed of; and
- the disposal occurs at the earliest practical date after identification of the issue, but no later than 30 days after the person has both the knowledge of the financial interest and the right or ability to dispose of it, or the person is removed from the engagement team.

70. When an inadvertent breach of the principles relating to a financial interest in an assurance client has occurred, the firm should consider whether, and if so which, safeguards should be applied. Such safeguards might include:

- involving another member of the firm who is not, and has not been, on the engagement team to review the work done by the particular member involved in the breach; or

- excluding the particular person from any substantive decision-making concerning the assurance engagement.

Members are reminded that Rule 204.5 requires a member who has an interest that is precluded by this Rule to advise in writing a designated partner of the firm of the interest. Inadvertent breaches are also discussed in paragraph 35 of this Council Interpretation.

### **Audit or review clients**

71. Rule 204.4(2) provides that a member or firm may not perform an audit or review engagement for an entity if the member, firm or a network firm has a direct financial interest or a material indirect financial interest in the entity or in a related entity of the entity.
72. Rule 204.4(3) provides that a member or firm may not perform an audit or review engagement for an entity if a pension or other retirement plan of the firm or a network firm has a direct financial interest or a material indirect financial interest in the entity or in a related entity of the entity.
73. Rule 204.4(4) provides that a partner of a firm who holds, or whose immediate family holds, a direct financial interest or a material indirect financial interest in an audit or review client of the firm, or a related entity of the client, may not practice in the same office as the lead engagement partner for the client.
74. The office in which the lead engagement partner practices in connection with an audit or review engagement is not necessarily the office to which that partner is ordinarily assigned. Accordingly, for the purposes of Rule 204.4 (4) and this Council Interpretation, when the lead engagement partner is located in a different office from others on the engagement team, professional judgment should be exercised to determine in which office the partner practices in connection with the audit or review engagement.
75. Rule 204.4(5) provides that a partner or managerial employee of a firm who holds, or whose immediate family holds, a direct financial interest or a material indirect financial interest in an audit or review client of the firm, or in a related entity of the client, may not provide a non-assurance service to the client, unless the non-assurance service is clearly insignificant.
76. Subject to Rule 204.4(7), a financial interest in an audit or review client, or a related entity of the client, that is held by an immediate family member of:
  - a partner located in the office in which the lead engagement partner practices in connection with the audit or review engagement; or
  - a member of the firm who provides a non-assurance service to the client;would not create an unacceptable threat to independence provided the financial interest is received as a result of the immediate family member's employment rights (e.g., pension rights or share options) and, where appropriate, safeguards are applied to reduce any threat to independence to an acceptable level.
77. A self-interest threat may exist if the firm, or the network firm, or a person on the engagement team has a financial interest in a particular entity, and an audit or review client or a director, officer or controlling owner thereof also has a financial interest in that entity. Independence is not impaired with respect to the audit or review client if the respective financial interests of the firm, the network firm, or person on the engagement team, and the client or director, officer or

controlling owner thereof are immaterial and the client cannot exercise significant influence over the entity.

78. Rule 204.4(6) provides that a member or firm may not perform an audit or review engagement for a client if the firm or a network firm has a financial interest in another entity, and the member or firm knows that the client or a director, officer or controlling owner of the client also has a financial interest in the other entity, unless the respective financial interests referred to are immaterial and the client cannot exercise significant influence over the other entity. In addition, a member or student may not participate on the engagement team for an audit or review client if that person has a financial interest in another entity and knows that the client or a director, officer or controlling owner of the client also has a financial interest in the entity, unless the respective financial interests referred to are immaterial and the client cannot exercise significant influence over the entity.
79. Rule 204.4(7) provides that a member or a firm may not perform an audit or review engagement for an entity if a partner or a professional employee of the firm owns, or such person's immediate family owns, more than 0.1% of the securities of the entity or controls the entity by means other than the ownership of the majority of the entity's common shares. The rule further provides that such interest may not be held in a related entity of the entity.
80. Rule 204.4(8) provides that a member or student may not participate on the engagement team of an audit or review client if such person knows that his or her close family owns more than 0.1% of the securities of the client, or a related entity of the client, or controls the client, or related entity of the client, by means other than the ownership of the majority of the entity's common shares. Rule 204.4(8) only applies when the person has knowledge of the securities held by his or her close family member. The rule does not put an onus on the person to determine which, if any, securities his or her close family members hold.

#### **Assurance clients that are not audit or review clients**

81. Rule 204.4(9) provides that a firm may not have a direct financial interest or a material indirect financial interest in an assurance client that is not an audit or review client. It also provides that a firm may not have a material financial interest in an entity that has a controlling interest in an assurance client that is not an audit or review client. The rule does not extend to related entities of the client.
82. With respect to a restricted-use report for an assurance engagement that is not an audit or review engagement, members are referred to the provisions in paragraph 28 of this Council Interpretation.

#### **B. LOANS AND GUARANTEES**

83. Rule 204.4(10) provides that a firm may not have a loan from or have a loan guaranteed by an assurance client except where the client is a bank or similar financial institution and the loan or guarantee is immaterial to the firm and the client and the loan or guarantee is made under normal commercial terms and conditions and is in good standing. The rule further provides that a firm may not make a loan to an assurance client that is not a bank or similar financial institution nor guarantee a loan of an assurance client.

84. Rule 204.4(11) provides that a firm may not accept a loan from, or have a loan guaranteed by an officer or director of an assurance client, or a shareholder of the client who owns more than 10% of its equity securities. In addition, a firm shall not make a loan to, or guarantee a loan of, such a person.
85. Rule 204.4(12) provides that a member or student may not participate on the engagement team for an assurance client of the firm if:
- (a) the member or student accepts a loan from, or has a loan guaranteed by, the client, unless the client is a bank or similar financial institution and the loan or guarantee is made under normal commercial terms and conditions and the loan is in good standing;
  - (b) the member or student accepts a loan from, or has a loan guaranteed by, an officer or director of the client, or a shareholder of the client who owns more than 10% of its equity securities; or
  - (c) the member or student has made a loan to, or guaranteed the borrowings of the client that is not a bank or similar financial institution, an officer or director of the client, or a shareholder of the client who owns more than 10% its equity securities.
86. A loan from, or a loan guaranteed by, from an assurance client that is a bank or a similar financial institution to a person on the engagement team or his or her immediate family member would not create a threat to independence provided the loan or guarantee is made under normal commercial terms and conditions and is in good standing. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.
87. Similarly, deposits or brokerage accounts of a firm or a person on the engagement team with an assurance client that is a bank, broker or similar financial institution would not create a threat to independence provided the deposit or brokerage account was held under normal commercial terms and conditions.
88. Rules 204.4 (10) and (11) relate to loans and guarantees between a firm and an assurance client. In the case of an assurance client that is an audit or review client, the provisions of Rules 204.4 (10) and (11) also apply to network firms. In the case of an assurance client that is an audit or review client the provisions of Rule 204.4(10), (11) and (12) should be read as applying also to related entities of the client.

### **C. CLOSE BUSINESS RELATIONSHIPS**

89. A close business relationship between a firm, a network firm or a person on the engagement team and the assurance client or its management, involving a common commercial or financial interest may create a self-interest or an intimidation threat. The following are examples of such relationships:
- (a) having a material financial interest in a joint venture with the client or a controlling owner, director, officer or other individual who performs senior management functions for that client;
  - (b) arrangements to combine one or more services or products of the firm with one or more services or products of the client and to market the package with reference to both parties; and
  - (c) arrangements under which either the firm or the client acts as a distributor or marketer of the other's products or services.
- A close business relationship does not include the relationship created by the professional engagement between the client and the member, the firm, or the network firm as the case may be.
90. Rule 204.4(13) provides that a firm or a network firm may not have a close business relationship with an audit or review client or its management unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant

to the firm or network firm and the client or its management. In the case of an assurance client that is not an audit or review client, a firm may not have a close business relationship with the client or its management unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant to the firm and the client or its management, as the case may be.

91. Rule 204.4(13) also provides that a member or student who has a close business relationship with an assurance client (whether audit, review or other) or its management may not be on the engagement team for the client unless that relationship is limited to a financial interest that is immaterial and the relationship is clearly insignificant to the member or student and the client or its management.
92. In the case of an audit or review client, a business relationship involving an interest held by a firm, a network firm or a person on the engagement team or any of that person's immediate family in a closely held entity in which the client or a director or officer of the client, or any group thereof, also has an interest, does not create threats to independence provided:
  - the relationship is clearly insignificant to the firm, the network firm and the client;
  - the interest held is immaterial to the investor, or group of investors; and
  - the interest does not give the investor, or group of investors, the ability to control the closely held entity.
93. The purchase of goods or services from an assurance client by a firm (and, in the case of an audit client, by a network firm) or a person on the engagement team will not generally create a threat to independence, provided the transaction is conducted in the normal course of the client's business and on an arm's length basis. However, such a transaction may be of a nature or magnitude such that it does create a self-interest threat. If the threat so created is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
  - reducing the magnitude of or eliminating the transaction;
  - removing the individual involved from the engagement team; or
  - discussing the issue with the audit committee.

#### **D. FAMILY AND PERSONAL RELATIONSHIPS**

94. Family and personal relationships between a person on an engagement team and a director, officer or certain employees, depending on their role, of the assurance client may create a self-interest, familiarity or intimidation threat. The significance of such a relationship will depend on a number of factors, including the person's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there are many circumstances that involve a threat to independence that will require evaluation.
95. Rule 204.4(14) provides that a member or a student may not participate on the engagement team for an assurance client if such person's immediate family is a director or officer of the client or an employee of the client in a position to exert direct and significant influence over the subject matter of the engagement, or was in such a position during any period covered by the engagement.
96. When a close family member of a person on the engagement team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter of the assurance engagement, a threat to independence may be created. The significance of the threat will depend on factors such as:
  - the position the close family member holds with the client; and
  - the role of the particular person on the engagement team.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:

- removing the particular person from the engagement team;
- where possible, restructuring the engagement team's responsibilities so that the particular person does not deal with matters that are within the responsibility of the close family member; or
- policies and procedures to empower staff to communicate, without fear of retribution, to senior levels within the firm any issue of independence and objectivity that may concern them.

97. A self-interest, familiarity or intimidation threat may exist when a director, officer or employee of an assurance client who is not an immediate or close family member of a person on the engagement team has a close relationship with a person on the engagement team, and is in a position to exert direct and significant influence over the subject matter of the assurance engagement. Those on the engagement team should identify such individuals, and evaluate the relationship and consult with others in the firm in accordance with its policies and procedures. The

evaluation of the significance of any such threat and the availability of safeguards appropriate to eliminate it or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the client.

98. Consideration should be given to whether a self-interest, familiarity or intimidation threat exists because of a personal or family relationship between a member of the firm who is not part of the engagement team and a director, officer or employee of the assurance client who is in a position to exert direct and significant influence over the subject matter of the assurance engagement. Members of the firm should identify and evaluate the relationship and consult with others in the firm in accordance with its policies and procedures. The evaluation of the significance of any threat and the availability of safeguards appropriate to eliminate it or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the member of the firm with the engagement team, the position held within the firm, and the role of the individual within the client.

99. An inadvertent breach of the principles in this Council Interpretation as they relate to family and personal relationships would not impair the independence of a member of the firm, or a firm, when:

- the firm has established policies and procedures that require all members of the firm to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create a threat to independence;
- either the responsibilities of the engagement team are restructured so that the person on the engagement team does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if that is not possible, the firm promptly removes that person from the engagement team; and
- additional care is given to reviewing the work of the particular person on the engagement team.

100. When an inadvertent breach of the principles in this Council should consider whether, and if so which, safeguards should be applied. Such safeguards might include:

- involving another member of the firm who is not, and never was, on the engagement team to review the work done by the person on the engagement team; or
- excluding that person from any substantive decision-making concerning the assurance engagement.

Members are reminded that Rule 204.5 requires a member who has a relationship that is precluded by this Rule to advise in writing a designated partner of the firm of the interest. Inadvertent breaches are also discussed in paragraph 35 of this Council Interpretation.

### **Audit clients that are listed entities**

101. Rule 204.4(15) provides that a member or a student may not participate on the engagement team for an audit client that is a listed entity if such person's close family is in an accounting role or a financial reporting oversight role at the client, or was in such a position during any period covered by the engagement.

## **E. EMPLOYMENT WITH AN ASSURANCE CLIENT**

### **General provisions**

102. The independence of a firm or a person on the engagement team may be threatened if a director, officer or employee of the assurance client in a position to exert influence over the subject matter of the assurance engagement has been on the engagement team or a partner of the firm. Such circumstances may create a self-interest, familiarity or intimidation threat, particularly when a significant connection remains between the individual and his or her former firm.

103. The significance of a threat so created will depend upon the following factors:
- the position the individual has taken at the client and whether the position involves direct or significant influence over the subject matter;
  - the amount of any involvement the individual will have with the engagement team;
  - the length of time since the individual was on the engagement team or with the firm; and
  - the former position of the individual within the engagement team or firm.

The significance of such a threat should be evaluated and, if it is other than clearly insignificant, available safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- considering the appropriateness or necessity of modifying the plan for the assurance engagement;
- assigning an engagement team to the subsequent assurance engagement that is of sufficient seniority and experience in relation to the individual who has joined the assurance client;
- involving another member of the firm who is not, and never was, on the engagement team to review the work done or advise as necessary; or
- performing an additional quality control review of the assurance engagement by the firm.

In such cases, all of the following safeguards will be necessary to reduce the threat to an acceptable level:

- the particular individual is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed predetermined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence; and
- the particular individual does not continue to participate or appear to participate in the firm's business or professional activities.

104. A self-interest threat exists when a person on the engagement team participates in the assurance engagement while knowing, or having reason to believe, that he or she will or may join the client. In all such cases the following safeguards should be applied:

- having firm policies and procedures that require those on the engagement team to notify the firm when entering employment negotiations with the assurance client; and
- removing the person from the engagement team.

In addition, consideration should be given to performing an independent review of any significant judgments made by that person while performing the engagement.

### **Audit clients that are listed entities**

105. Notwithstanding the general guidance in paragraphs 102 to 104 of this Council Interpretation, Rule 204.4(16) provides that a firm may not perform an audit engagement for a client that is a listed entity if a person who participated in an audit capacity in an audit of the financial statements of the client is employed in a financial reporting oversight role for the client within a period of one year after the date when the financial statements of the client were filed with the relevant securities regulator or stock exchange. An individual holding one of the following titles will generally be considered to be in a financial reporting oversight role: a member of the board of directors or similar management or governing body, president, chief executive officer, chief operating officer, chief accounting officer, controller, director of internal audit, director of financial reporting, treasurer, and, depending upon the particular facts and circumstances, the general counsel.
106. The term “financial reporting oversight role” means a position in which a person may or does exercise influence over either the contents of the financial statements or anyone who prepares them. When the financial statements of the listed entity are consolidated, a financial reporting oversight role can extend to the listed entity and its subsidiaries. In determining whether an individual is in a financial reporting oversight role for the listed entity, consideration should be given to the position of the individual, the extent of the individual's involvement in the financial reporting process of the listed entity and the impact of the individual's role of the consolidated financial statements of the listed entity.
107. For the purposes of Rule 204.4(16), other than the lead engagement partner and the engagement quality control reviewer, the following persons are not considered to have participated in an audit capacity in an earlier audit:
- (a) a person who is employed by the listed entity due to an emergency or other unusual situation provided that the entity's audit committee has determined that the employment of such person is in the interest of the shareholders;
  - (b) a person who has provided ten or fewer hours of assurance services in the earlier audit;
  - (c) a person who recommended the compensation of, or who provided direct supervisory, management or oversight of, the lead engagement partner in connection with the performance of the earlier audit, including those at all successively senior levels above the lead engagement partner through to the firm's chief executive; and
  - (d) a person who provided quality control for the audit engagement.
108. An individual may have fully complied with Rule 204.4(16) in accepting employment with an entity, and subsequently thereto, the entity merged with or was acquired by another entity resulting in that individual having a financial reporting oversight role of a combined entity which is audited by the firm in which the individual was previously an employee or a partner. In such a circumstance, unless the employment offer was accepted in contemplation of the merger or acquisition, the individual or the entity could not be expected to know that the employment decision could result in a threat to independence. In all such cases the safeguard of informing the audit committee should be applied.
109. For the purposes of Rule 204.4(16) audit procedures are deemed to have commenced for the current audit engagement period on the day after the financial

statements for the previous period are filed with the relevant securities regulator or stock exchange.

## **F. RECENT SERVICE WITH AN ASSURANCE CLIENT**

110. A self-interest, self-review or familiarity threat may exist when a former officer, director or employee of an assurance client becomes a part of the engagement team for that client.
111. Rule 204.4(17) provides that a member or a student may not participate on the engagement team for an assurance client if such person served as an officer or director of the client or had been an employee thereof in a position to exert direct and significant influence over the subject matter of the engagement during the period covered by the assurance report.
112. If, prior to the period covered by an assurance report, a person on the engagement team served as an officer or on the board of directors of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter of the assurance engagement, a self-interest, self-review or familiarity threat may exist. For example, such a threat will exist if a decision made or work performed by that individual in the prior period, while employed by the client, is to be evaluated in the current period as part of the assurance engagement. The significance of the threat will depend upon factors such as:
- the position the individual held with the client;
  - the length of time since the individual left the client; and
  - the role of the individual on the engagement team.
- The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- involving another member of the firm who is not, and never was, on the engagement team to review the work of the particular person or advise as necessary; or
  - discussing the issue with the audit committee.

## **G. SERVING AS AN OFFICER OR A MEMBER OF THE BOARD OF DIRECTORS OF AN ASSURANCE CLIENT**

113. Rule 204.4(18) provides that a member of a firm may not serve as an officer or director for an assurance client. In the case of an audit or review client, this prohibition is extended to related entities of the client and members of network firms by Rule 204.4 (19). However, a partner or employee of a network firm may serve as company secretary for an audit or review client that is not a listed entity where permitted by local law, professional rules or practice, and the duties and functions undertaken are limited to those of a routine and formal administrative nature.

### **Company secretary**

114. The position of company secretary has different implications in different jurisdictions. The duties of company secretary may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.
115. If a partner or employee of a network firm serves as company secretary for an audit or review client, the self-review and advocacy threats created would generally be so significant that safeguards are unlikely to be available to reduce the threats to an acceptable level. However, when the practice of acting as company secretary is specifically permitted under local law, professional rules or practice, the duties and functions

undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.

116. Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

## **H. RELIGIOUS ORGANIZATIONS**

117. A threat to independence is ordinarily not created when a person on the engagement team, or any of the person's immediate or close family, belongs to a religious organization that is an assurance client provided the person on the engagement team, or the immediate or close family member:
- (a) does not serve on the religious organization's governing body; and
  - (b) does not have the right or responsibility to exercise significant influence over the financial or accounting policies of the religious organization or any of its associates.

## **I. SOCIAL CLUBS**

118. Notwithstanding Rules 204.1 to 204.4, a threat to independence is ordinarily not created when a person on the engagement team, or an immediate or close family member of the engagement team, holds qualifying shares in a social club, such as a golf club, curling club, co-operative or similar organization, where the shareholding is a prerequisite of club membership, provided:
- (a) the assets of the organization cannot by virtue of the organization's by-laws be distributed to the individual club members other than in circumstances of forced liquidation or expropriation, unless there is a written undertaking with the organization to forfeit entitlement to such distributed assets;
  - (b) neither the person on the engagement team nor the immediate or close family member:
    - (i) serves on the governing body or as an officer of the organization;
    - (ii) has the right or responsibility to exercise significant influence over the financial or accounting policies of the organization or any of its associates; or
    - (iii) exercises any right derived from membership to vote at meetings of the organization; and
  - (c) the club member cannot dispose of the membership for gain.
119. The use of the same senior personnel on the engagement team on an assurance engagement over a long period of time may create a familiarity threat. The significance of such a threat will depend upon factors such as:
- the length of time that the particular individual has been on the engagement team;
  - the role of that individual on the engagement team;
  - the structure of the firm; and
  - the nature of the assurance engagement including the complexity of the subject matter and degree of professional judgment needed.
- The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- discussing the matter with the audit committee;
  - replacing the senior personnel on the engagement team;
  - involving an additional member of the firm who is not, and never was, on the engagement team to review the work done by the particular individual, or advise as necessary;
  - the member or firm is subject to external practice inspection; or
  - an independent internal quality review of the assurance work performed by a member of the firm who was not part of the engagement team.

## **Audit clients that are listed entities**

120. Rule 204.4(20) provides that a member may not continue as the lead engagement partner, or the engagement quality control reviewer, for an audit client that is a listed entity for more than five years in total and shall not resume or assume either such role until five years have elapsed since the member ceased to be the lead engagement partner or the engagement quality control reviewer. Rule 204.4(20) also provides that a member, who is another partner on the engagement team, providing, during the engagement period, more than ten hours of assurance services in connection with the annual financial statements or interim financial information of the listed entity or is a subsidiary engagement partner may not provide such services for a period of more than seven years in total and shall not resume providing such services until two years have elapsed since the member ceased to provide such services. These provisions do not apply to those “speciality” and “technical” partners who consult with others on the engagement team regarding technical or industry-specific issues, transactions or events, including taxation matters. In addition, the provisions do not apply to those partners who, subsequent to the issuance of the audit report, provide quality control for the engagement. Such partners typically have a low level of involvement with senior management as well as a relatively low level responsibility for overall presentation in the financial statements.
121. The effect of Rule 204.4(20) is that if a member had been the lead engagement partner for an audit client that is a listed entity for three consecutive years and was the engagement quality control reviewer for the following year, the member could be the lead engagement partner or the engagement quality control reviewer for one further year. After serving in such a role for one further year, the member would have served in such roles for five years and, therefore, would be subject to a five-year “time out” period before the member could resume the role of lead engagement partner or engagement quality control reviewer for the particular listed entity.
122. When an audit client becomes a listed entity, the length of time the lead engagement partner has served in that capacity should be considered in determining when the partner must be replaced on the engagement team. However, if the lead engagement partner has served in that capacity for three or more fiscal years at the time the client becomes a listed entity, such person may continue in that capacity for two more fiscal years before being replaced as lead engagement partner.

## **K. AUDIT COMMITTEE PRIOR APPROVAL OF SERVICES TO A LISTED ENTITY AUDIT CLIENT**

123. Rule 204.4(21) provides that a member or firm may not provide a service to a listed entity, that is an audit client, or to a subsidiary thereof, unless the audit committee of the client pre-approves such service. The requirement applies to all audit and non-audit services. For the purpose of Rule 204.4(21) the audit committee recommendation to the entity’s board of directors that the particular audit firm be the entity’s auditor will be considered to be the approval of the audit service. Subject to paragraph 125, all non-audit services for the listed entity and its subsidiaries must be specifically pre-approved by the audit committee.
124. The audit committee may establish policies and procedures for pre-approval provided that they are detailed as to the particular services and designed to safeguard the independence of the member and the firm. For example, one or more audit committee members who are independent board directors may pre-approve the service provided decisions made by the designated audit committee members are reported to the full audit committee.
125. Notwithstanding Rule 204.4(21), audit committee pre-approval of services other than assurance services provided to an audit client that is a listed entity, or to a subsidiary of the client, is not required where all such services that have not been pre-approved:

- (a) do not represent more than five per cent of total revenues paid by the audit client to the member, the firm and network firms in the fiscal year in which the services are provided;
- (b) were not recognized as non-audit services at the time of the engagement; and
- (c) are promptly brought to the attention of the audit committee and the audit committee or one or more designated representatives approves the services prior to the completion of the audit.

126. For the purposes of Rule 204.4(21) audit services include all those services performed to discharge responsibilities to provide an opinion on the financial statements of the listed entity. For example, in connection with some audit engagements, a tax partner may be involved in reviewing the tax accrual of the client. Since it is a necessary part of the audit process, the activity constitutes an audit service. Similarly, complex accounting issues may require consultation with a national office technical partner to reach an audit judgment. That consultation, being a necessary part of the audit process, also constitutes an audit service, and as such will be considered to have been pre-approved by the audit committee whether or not the firm charges separately for it. These examples contrast with a situation where a client is evaluating a proposed transaction and requests the member, the firm or a network firm to evaluate it and, after research and consultation, the member, firm or network firm provides an answer to the client and bills for those services. Such services would not be considered to be audit services and, therefore, will not be considered to have been pre-approved with the audit service.

## **L. PROVISION OF NON-ASSURANCE SERVICES TO AN ASSURANCE CLIENT**

### **General provisions**

127. Firms have traditionally provided to their assurance clients a range of other services that are consistent with their skills and expertise. The provision of a service not referred to in Rule 204.1 may, however, create a self-interest, self-review or advocacy threat to the independence of the member or firm. Consequently, before a firm accepts an engagement to provide a non-assurance service to an assurance client, it should evaluate the significance of any threat created by providing the service. When such a threat is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or threats or reduce them to an acceptable level.
128. Subject to any specific prohibition in these rules to the contrary, a firm or a member of a firm may provide a non-assurance service to an assurance client provided that any threats to independence have been reduced to an acceptable level by safeguards, such as:
- policies and procedures to prohibit members of the firm from making management decisions for the client, or assuming responsibility for such decisions;
  - discussing independence issues related to the provision of non-assurance services with the audit committee;
  - policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm;
  - involving another member of the firm who is not on the engagement team to advise on any impact of the non-assurance engagement on the independence of the persons on the engagement team and the firm;
  - involving a professional colleague from outside of the firm to provide assurance on a discrete aspect of the assurance engagement;
  - obtaining the client's acknowledgement of responsibility for the results of the work performed by the firm;
  - disclosing to the audit committee the nature of the engagement and extent of fees charged; or
  - arranging that the members of the firm providing the non-assurance service do not participate on the engagement team.

129. Notwithstanding the foregoing, the provision of certain non-assurance services to an audit or review client may create a threat to independence so significant that no safeguard will eliminate the threat or reduce it to an acceptable level. However, the provision of such a service to a related entity or division or the provision of a service that relates to a discrete financial statement item of the audit client may be permissible if all threats to the firm's independence have been reduced to an acceptable level by:
- arranging for that related entity, division or discrete financial statement item to be audited by another firm that is not a network firm; or
  - arranging for another firm that is not a network firm to re-perform the non-assurance service.
130. Rule 204.4(22) provides that, during the engagement period, a member of a firm may not make management decisions or perform management functions for an assurance client. The Rule further provides that in the case of an audit or review client a member of the firm or a network firm shall not make management decisions or perform management functions for the client during either the engagement period or the period covered by the financial statements subject to audit or review. Rule 204.4(22) also provides that in the case of an audit client that is a listed entity, a member of the firm or a network firm shall not make management decisions or perform management functions for a related entity of the client. Activities that would constitute a management decision or function include
- (a) authorizing, approving, executing or consummating a transaction;
  - (b) having or exercising authority on behalf of the client;
  - (c) determining which recommendation of the member or the firm should be implemented;
  - or (d) reporting in a management role to those charged with governance of the client.
131. Notwithstanding Rule 204.4(22) the independence of a member or a firm would not be impaired by the provision of services to assess the effectiveness of the internal control of an assurance client and to recommend improvements in the design and implementation of internal control and risk management control. Obtaining an understanding of the client's internal control is required by generally accepted auditing standards. Members often become involved in diagnosing, assessing and recommending to management ways in which internal control can be improved or strengthened.
132. The lending of staff by a firm or network firm to an audit or review client may create a self-review threat when a person so loaned is in a position to influence the preparation of the client's financial statements. In practice, such assistance may be given but only on the understanding that client approval is obtained for the results of the service and that the person on loan will not be involved in:
- making management decisions for the client;
  - approving or signing agreements or other similar client documents; or
  - exercising discretionary authority to commit the client.
- In such situations the circumstances should be carefully analyzed to identify any threat to independence created and to determine whether additional safeguards should be applied to reduce the threat to an acceptable level.
133. Rules 204.4(24) to (28) set out non-audit services that may not be provided during either the period covered by the financial statements subject to audit or during the engagement period to an audit client that is a listed entity unless it is reasonable to conclude that the results of any such service will not be subject to audit procedures during the audit of the client's financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of such services will be subject to audit procedures. Materiality is not an appropriate basis upon which to overcome this presumption. For example, determining whether a subsidiary, division or other unit of the consolidated entity is material is a matter of audit judgment. Therefore, the determination of whether to apply detailed audit procedures to a unit of a consolidated entity is, in itself, an audit procedure.

## General provisions

134. It is the responsibility of management to ensure that accounting records are kept and financial statements are prepared, although in discharging its responsibility management may request a member or firm to provide assistance.
135. Assisting an audit or review client in matters such as preparing accounting records or financial statements will create a self-review threat when the financial statements are subsequently audited or reviewed by the member or firm. The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level.
136. Rule 204.4(23) provides that a member, or a member of a firm or network firm, may not perform any of the following activities for an entity, including a listed entity, that is an audit or review client:
- (a) preparing, or changing a journal entry, determining or changing an account code, or a classification for a transaction or preparing or changing another accounting record without obtaining the approval of management of the entity;
  - (b) preparing or changing a source document or originating data in respect of any transaction undertaken or entered into by the entity.
137. A source document is an initial recording or original evidence of a transaction. Examples of source documents are purchase orders, payroll time cards, customer orders, invoices, disbursement approvals, signed cheques and written contracts. Source documents are often followed by the creation of additional records and reports, such as trial balances, account reconciliations and aged account receivable listings, which do not constitute source documents or initial recordings. Source documents may also be preceded by documents containing calculations and advice, such as bonus calculations for tax purposes, ceiling test calculations in the oil and gas industry and sample wording for clauses in a contract that will be prepared by the client's lawyers. The creation of such additional records, reports and documents would not constitute the creation of source documents.
138. Notwithstanding Rules 204.4(23) and (24), the financial statement audit and review process involves extensive dialogue between persons on the engagement team and management of the audit or review client. During this process, management will often request and receive input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. The provision of technical assistance of this nature for an audit or review client is an appropriate method of promoting the fair presentation of the financial statements. The provision of such advice, *per se*, does not generally threaten the member's or the firm's independence. Other services that are usually a part of the audit or review process and that do not, under normal circumstances, threaten independence include:
- assisting a client in resolving account reconciliation problems;
  - analyzing and accumulating information for regulatory reporting;
  - assisting in the preparation of consolidated financial statements (including assisting in the translation of local statutory accounts to comply with group accounting policies and transition to a different reporting framework such as International Accounting Standards);
  - assisting the drafting of disclosure items;
  - proposing adjusting journal entries; and
  - providing assistance and advice in the preparation of local statutory accounts of subsidiary entities.
139. A self-review threat may exist when a member, firm or network firm assists in the preparation of subject matter other than financial statements and subsequently provides assurance thereon. For example, a self-review threat will exist if a member or firm develops and prepares prospective financial information and subsequently provides

assurance on it. Consequently, a member or firm should evaluate the significance of any self-review threat created by the provision of such a service. If the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level.

#### *Audit or review clients that are not listed entities*

140. Subject to Rule 204.4(23) a member, firm or network firm may provide an audit or review client that is not a listed entity with accounting and bookkeeping services provided that any resulting self-review threat so created is reduced to an acceptable level. Examples of such services include:
- recording transactions for which the client has determined or approved the appropriate account classification;
  - posting transactions to the client's general ledger;
  - preparing financial statements;
  - drafting notes to the financial statements;
  - posting journal entries to the trial balance;
  - performing payroll services which do not involve having custody of client assets; and
  - preparing tax receipts for charitable donations or tax information returns, such as T4 slips.

#### *Client approval of journal entries*

141. A member, firm or network firm may prepare journal entries for an audit or review client that is not a listed entity provided management approves and takes responsibility for such journal entries. In obtaining this approval, the member, firm or network firm may choose to obtain approval for each journal entry or, alternatively, to obtain approval following a thorough review of the completed financial statements with management. This approval may also be obtained through the management representation letter.

#### *Evaluation of significance of threats*

142. The significance of a threat created by providing accounting and bookkeeping services to an auditor review client that is not a listed entity should be evaluated. The significance of such a threat will depend upon factors such as:
- the degree of involvement of the member or firm;
  - the complexity of the transactions to be accounted for; and
  - the extent of professional judgment required in selecting the appropriate accounting treatment.
- If the threat is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:
- making arrangements so that such services are not performed by a person on the engagement team;
  - requiring the client to create the source data for the accounting entries;
  - requiring the client to develop the underlying assumptions;
  - obtaining the views of another professional accountant;
  - arranging for another firm to review a significant accounting treatment; or
  - discussing a significant accounting treatment with the Director of Professional Standards or other Institute staff member.

#### *Complex transactions*

143. Preparing the journal entries for a complex transaction would likely create a self-review threat the significance of which could only be reduced to an acceptable level by applying safeguards that involve consultation with others, for example by:

- obtaining the views of another professional accountant;
- arranging for another firm to review a significant accounting treatment; or
- discussing the proposed accounting treatment with the Director of Professional Standards or other Institute staff member.

*Audit clients that are listed entities*

144. Rule 204.4(24) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide bookkeeping or other services related to the accounting records or financial statements of an audit client that is a listed entity, or of a related entity, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the financial statements. Bookkeeping and other such services include:
- (a) maintaining or preparing the entity's, or a related entity's, accounting records
  - (b) preparing the financial statements on which the audit report is provided or that form the basis of the financial statements on which the audit report is provided; and
  - (c) preparing or originating source data underlying such financial statements.
- In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the bookkeeping or other services will be subject to audit procedures.

**Valuation services**

*General provisions*

145. A valuation service involves the making of assumptions with respect to future events and the application of certain methodologies and techniques, in order to compute or provide an opinion with respect to a specific value or range of values, for a business as a whole, an intangible or tangible asset or a liability.

*Audit or review clients that are not listed entities*

146. Performing a valuation service for an audit or review client that is not a listed entity will create a self-review threat when the valuation resulting from the service is incorporated into the client's financial statements. The significance of such a threat should be evaluated. The significance will depend on factors such as:
- the materiality of the results of the valuation service;
  - the extent of the client's knowledge, experience and ability to evaluate the issues concerned, and the extent of the client's involvement in determining and approving significant matters of judgment;
  - the degree to which established methodologies and professional guidelines are applied when performing the particular valuation service;
  - the degree of subjectivity inherent in the item concerned where the valuation involves standard or established methodologies;
  - the reliability and extent of the underlying data;
  - the degree of dependence on future events of a nature which could create significant volatility in the amounts involved; and
  - the extent and clarity of the financial statement disclosures.
- If the threat is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- involving an additional professional accountant who was not a member of the engagement team to review the valuation work or otherwise advise as necessary;
  - confirming with the client its understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;

- obtaining the client's acknowledgement of responsibility for the results of the valuation work performed by the firm or network firm; or
  - arranging that members of the firm or network firm providing such services do not participate on the engagement team.
147. Performing a valuation service for an audit or review client that is not a listed entity involving matters that are material to the entity's financial statements and involving a significant degree of subjectivity would likely create a self-review threat. The significance of such a threat could only be reduced to an acceptable level by applying safeguards that involve consultation with others, such as another professional accountant or valuation specialist.
148. When a member, firm or network firm performs a valuation service for an audit or review client for the purposes of making a filing with a taxation authority, computing an amount of tax due by the client, or tax planning, no significant threat to independence ordinarily exists because such valuations are generally subject to the safeguard of external review by the taxation authority.
149. Notwithstanding Rule 204.4(25), the independence of a member or a firm will not be impaired when:
- the firm's valuation specialist reviews the work of an audit or review client or a specialist employed by the client, provided the client or the client's specialist supplies the technical expertise that the client uses in determining the required amounts recorded in the financial statements. In such circumstances there will be no self-review threat because a client's management or a third-party is the source of the financial information subject to audit; or
  - the valuation service is provided for non-financial reporting purposes, for example, transfer pricing studies or other tax-only purposes.
150. When a member or firm performs a valuation that forms part of the subject matter of an assurance engagement that is not an audit or review engagement, the firm should consider whether there is a self-review threat. If such a threat exists, and it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level.

*Audit clients that are listed entities*

151. Rule 204.4(25) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide a valuation service to an audit client that is a listed entity, or to a related entity, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the valuation service will be subject to audit procedures.

**Provision of actuarial services to a listed entity audit client**

152. Rule 204.4(26) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not perform an actuarial service for an audit client that is a listed entity, or to a related entity, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the actuarial service will be subject to audit procedures.
153. For the purposes of Rule 204.4(26), actuarial services include the determination of an amount to be recorded in the client's financial statements and related accounts, except for: services that involve assisting the client in understanding the methods, models,

assumptions and inputs used in determining such amounts; and advising management on the appropriate actuarial methods and assumptions that will be used in the actuarial valuations. In addition, the firm may use its own actuary to assist in conducting the audit if the client's actuary or a third-party actuary provides management with its actuarial capabilities.

## **Provision of internal audit services to an audit or review client**

### *General provisions*

154. A self-review threat may exist when a member, firm or network firm provides internal audit services to an audit or review client. Such services may comprise an extension of the firm's audit service beyond the requirements of generally accepted auditing standards as contemplated in the *CICA Handbook — Assurance*, assistance in the performance of the client's internal audit activities, or outsourcing of the activities. In evaluating any threat to independence, the nature of the service should be considered.
155. Services involving an extension of the procedures required to conduct an audit or review in accordance with the *CICA Handbook — Assurance* will not be considered to impair independence with respect to an audit or review client provided that a member of the firm or network firm does not act or appear to act in the capacity of the client's management.
156. During the course of an audit or review engagement the engagement team considers the client's internal control and, as a result, may make recommendations for its improvement. This is part of an audit or review engagement and is not considered to be an internal audit service
157. For the purposes of Rule 204.4 and this Council Interpretation, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.
158. Safeguards that should be applied in all circumstances to reduce any threats created by performing internal audit services for an audit or review client to an acceptable level include ensuring that:
  - the client is responsible for internal audit activities and acknowledges in writing, to the firm and the audit committee, its responsibility for establishing, maintaining and monitoring the system of internal controls;
  - the client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;
  - the client or the audit committee approves the scope, risk and frequency of internal audit work;
  - the client is responsible for evaluating and determining which recommendations of the firm should be implemented;
  - the client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, for example, obtaining and acting on reports from the member, firm or network firm; and
  - the findings and recommendations resulting from the internal audit services performed by the member, firm or network firm are reported appropriately to the audit committee.
159. Consideration should also be given to whether the provision of internal audit services to an audit or review client should be provided only by a member or members of the firm not involved in the audit or review engagement and with different reporting lines within the firm.
160. Performing a significant portion of the audit or review client's internal audit activities may create a self-review threat and a member, firm or network firm should consider that possibility and proceed with caution before taking on such an activity.

161. Rule 204.4(27) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide an internal audit service to an audit client that is a listed entity, or to a related entity, that relates to the client's, or the related entity's, internal accounting controls, financial systems or financial statements, unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the financial statements. In determining whether such a conclusion is reasonable, there is a rebuttable presumption that the results of the internal audit service will be subject to audit procedures.
162. Rule 204.4(27) does not prohibit the member, firm or network firm from providing a nonrecurring service to evaluate a discrete item or program, if the service is not in substance the outsourcing of an internal audit function. For example, the member, firm or network firm, or a member of the firm of a network firm, may conduct a nonrecurring specified auditing procedures engagement related to the internal control of an audit client that is a listed entity

### **Provision of IT system services to an audit or review client**

#### *General provisions*

163. The provision of services by a member, firm or network firm to an audit or review client that involve the design or implementation of financial information technology systems that are, or will be, used to generate information forming part of the client's financial statements may create a self-review threat.

#### *Audit or review clients that are not listed entities*

164. The provision of services by a member, firm or network firm to an audit or review client that involve both the design and the implementation of such financial information technology systems would create a self-review threat that is likely to be too significant to allow the provision of such services to an audit or review client that is not a listed entity, unless appropriate safeguards are put in place ensuring that:
- the client acknowledges in writing to the firm and the audit committee its responsibility for establishing and monitoring a system of internal controls;
  - the client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;
  - the client makes all management decisions with respect to the design and implementation process;
  - the client evaluates the adequacy and results of the design and implementation of the system; and
  - the client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.
165. Consideration should also be given to whether such services should be provided only by members of the firm who are not part of the engagement team with different reporting lines within the firm.
166. The provision of services by a member, firm or network firm to an audit or review client that involve either the design or the implementation of financial information technology systems that are used to generate information forming part of the client's financial statements may also create a self-review threat. The significance of any threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level.
167. The provision of services to an audit or review client by a member, firm or network firm in connection with the assessment, design and implementation of internal accounting controls

and risk management controls is not considered to create a threat to independence provided that members of the firm or network firm do not perform management functions for the client.

168. Recommending or installing pre-packaged financial information technology software for an audit or review client that is not a listed entity generally will not create a threat to independence.

*Audit clients that are listed entities*

169. Rule 204.4(28) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or network firm, or a member of the firm or a network firm, may not design or implement a financial information system for an audit client that is a listed entity, or for a related entity, unless it is reasonable to conclude that the results of such service will not be subject to audit procedures during an audit of the client's financial statements. Such services involve:
- (a) directly or indirectly operating, or supervising the operation of, the entity's, or a related entity's, information system;
  - (b) designing or implementing a hardware or software system that aggregates source data underlying the financial statements or generates information that is significant to the entity's, or a related entity's, financial statements or other financial information systems taken as a whole; or
  - (c) directly or indirectly managing the entity's, or a related entity's, local area network.
- In determining whether it is reasonable to conclude that the results of such service will not be subject to audit procedures, there is a rebuttable presumption that the results of the financial information systems design and implementation service will be subject to audit procedures.
170. Information will be considered to be significant if it is reasonably likely to be material to the financial statements. Since materiality determinations may not be complete before the financial statements are prepared, the audit client and the member or firm should evaluate the general nature of the information as well as system output during the period of the audit engagement.
171. Notwithstanding Rule 204.4(28), a member, a firm or a network firm may:
- design or implement a hardware or software system that is unrelated to the financial statements or accounting records of the listed entity, or a related entity;
  - as part of the audit, or another assurance engagement, evaluate and make recommendations to management on the internal control of a system as it is being designed, implemented or operated; or
  - make recommendations on internal control matters to management or other service provider in conjunction with the design and installation of a system by another service provider.

**Provision of litigation support or expert services to an audit or review client**

*General provisions*

172. Litigation support services include such activities as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a legal dispute or litigation.
173. A self-review threat may exist when a member, firm or network firm provides to an audit or review client litigation support services that include the estimation of the possible outcome of a dispute or

litigation and thereby affects the amounts or disclosures to be reflected in the client's financial

statements. The significance of any such threat will depend upon factors such as:

- the nature of the engagement;
- the materiality of the amounts involved; and
- the degree of subjectivity inherent in the matter concerned.

The member or firm should evaluate the significance of any threat so created and, if it is other

than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable

level. Such safeguards might include:

- policies and, procedures to prohibit individuals who assist the client from making management decisions on the client's behalf;
- using a member of the firm who is not part of the engagement team to perform the litigation support service; or
- the involvement of others, such as independent specialists.

If adequate safeguards are not available to reduce a threat to an acceptable level the member, firm or network firm should decline the engagement.

### **Provision of expert services to a listed entity audit client**

174. Rule 204.4(29) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, a firm or a network firm, or a member of the firm or a network firm, may not provide an expert opinion or other expert service for an audit client that is a listed entity, or for a related entity, or for a legal representative thereof. This rule prohibits a member, firm or network firm, or a member of the firm or a network firm, from performing an engagement to provide specialized knowledge, experience or expertise to advocate or support the audit client's positions, or the positions of a related entity, in an adversarial or similar proceeding such as an investigation, a litigation matter, or a legislative or administrative tribunal.

175. Notwithstanding Rule 204.4(29), a member, a firm or a network firm, or a member of the firm or a network firm, may be engaged by an audit committee of an audit client that is a listed entity to assist it in fulfilling its responsibilities to conduct its own investigation of a potential accounting impropriety. For example, if the audit committee is concerned about the accuracy of the inventory records at a subsidiary, it may engage the member, the firm or the network firm, or a member of the firm or a network firm, to conduct a thorough inspection and analysis of these records, the physical inventory at the subsidiary and related matters without impairing independence. This type of engagement may include forensic or other fact-finding work that results in the issuance of a report to the audit client. It will generally require performing procedures that are consistent with, but more detailed or more comprehensive than, those required by generally accepted auditing standards.

176. In an investigation or proceeding for an audit client that is a listed entity, or for a related entity, the member, firm or network firm, or a member of the firm or a network firm, may provide an account or testimony with respect to a matter of fact, such as describing the work performed by the member's firm or the predecessor auditor. The member, firm or network firm, or a member of the firm or network firm, may explain the positions taken or the conclusions reached during the performance of any service provided for the listed entity audit client.

### **Legal services to an audit or review client**

#### *General provisions*

177. A legal service refers to any service that may only be provided by a person licensed, admitted, or otherwise qualified to practice law in the jurisdiction in which the service is provided. Legal services encompass a wide and varied range of corporate and commercial services, including contract support, conduct of litigation, mergers and acquisition advice and support and the provision of assistance to client's internal legal departments. For the purposes of Rule 204.4 legal services do not include those taxation services that may be provided by a person who is not admitted to the practice of law in the jurisdiction.
178. Threats to independence created by the provision of legal services to an audit or review client should be considered based on:
- the nature of the service to be provided (for example, advocacy as opposed to other legal services);
  - whether the service provider is separate from the engagement team; and
  - the materiality of any pertinent matter in relation to the client's financial statements.
179. The provision of a legal service which involves matters that would not be expected to have a material effect on the client's financial statements is not considered to create an unacceptable threat to independence with respect to that client.
180. The provision of legal services to support an audit or review client in the execution of a transaction (e.g., contract *support*, legal advice, legal due diligence and restructuring) may create a self-review threat. The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- using a member of the firm who is not on the engagement team to provide the service;
  - ensuring the member of the firm does not make a management decision for the client;
  - ensuring the client makes the ultimate decision in relation to the advice provided; and
  - ensuring the service involves the execution of what has been decided by the client in relation to the transaction.
181. Notwithstanding the foregoing, Rule 204.4(30) provides that a member, firm or network firm may not, during either the period covered by the financial statements subject to audit or review or the engagement period, provide a legal service to an audit or review client in the resolution of a dispute or litigation in circumstances where the matters in dispute or subject to litigation are material in relation to the client's financial statements.
182. The provision of a legal service to assist an audit or review client in the resolution of a dispute or litigation may create an advocacy or self-review threat. When a member, firm or network firm is asked to act in an advocacy role for the client in the resolution of a dispute or litigation in circumstances where the amounts involved are not material to the client's financial statements, the significance of any resulting threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to eliminate it or reduce it to an acceptable level. Such safeguards might include:
- policies and procedures to prohibit members of the firm or network firm from assisting the client in making management decisions on behalf of the client; or
  - using members of the firm who are not on the engagement team to perform the particular legal service.

*Audit clients that are listed entities*

183. Rule 204.4(31) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide a legal service to an audit client that is a listed entity, or to a related entity.

## **Human resource services for an assurance client**

### *General provisions*

184. The recruitment of managers, executives or directors for an assurance client, where the person recruited will be in a position to affect the subject matter of the assurance engagement, may create a current or future self-interest, familiarity or intimidation threat. The significance of such a threat will depend upon factors such as:
- the role of the person to be recruited; and
  - the nature of the assistance sought.
- The significance of any such threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. In all cases, the firm should not make management decisions and the client should make the hiring decision.

### *Audit clients that are listed entities*

185. Rule 204.4(32) provides that, during either the period covered by the financial statements subject to audit or the engagement period, a member, firm or network firm, or a member of the firm or a network firm, may not provide any of the following services to an audit client that is a listed entity, or to a related entity:
- (a) searching for or seeking out prospective candidates for management, executive, or director positions;
  - (b) engaging in psychological testing, or other formal testing or evaluation programs;
  - (c) undertaking reference checks of prospective candidates for an executive or director position;
  - (d) acting as a negotiator or mediator on the entity's behalf with respect to employees or future employees with respect to any condition of employment, including position, status or title, compensation, or fringe benefits; or
  - (e) recommending or advising the entity to hire a specific candidate for a specific job.
- Notwithstanding Rule 204.4(32) a member, firm or network firm, or a member of the firm or a network firm may, upon request of the audit client, interview candidates and advise the client on the candidate's competence for financial accounting, administrative or control positions.

## **Corporate finance and similar activities**

186. Rule 204.4(33) provides that, during the engagement period, a member or firm, or a member of the firm, may not provide any of the following services to an assurance client:
- (a) promoting, dealing in or underwriting the client's securities;
  - (b) making investment decisions on behalf of the client or otherwise having discretionary authority over the client's investments;
  - (c) executing a transaction to buy or sell the client's investments; or
  - (d) having custody of assets of the client, including taking temporary possession of securities purchased by the client.
- The Rule further provides that in the case of an assurance client that is an audit or review client, during either the period covered by the financial statements subject to audit or the engagement period, a network firm or a member of a network firm shall not provide such services to the client. It also provides that in the case of an audit client that is a listed entity, the firm, a network firm, or a member of the firm or network firm shall not provide such services to a related entity.

187. Other corporate finance services may create an advocacy or self-review threat that may be reduced to an acceptable level by the application of safeguards. Examples of such services include:
- assisting a client in developing corporate strategies; assisting a client in obtaining bank financing by explaining the financial statements to the bank; assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria; and providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions. The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce the threat to an acceptable level. Such safeguards might include:
- policies and procedures to prohibit members of the firm from making management decisions on behalf of the client; and
  - using members of the firm not part of the engagement team to provide the services.

### **Provision of taxation services to an audit or review client**

188. Members and firms have historically provided a broad range of tax services to their audit and review clients, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Taxation services are seen to be unique among non-assurance services for several reasons. Detailed tax laws must be consistently applied, and the Canada Customs and Revenue Agency has discretion to audit any tax filing. Accordingly such engagements are generally not seen to create threats to independence that are not adequately offset by available safeguards.
189. There are, however, some taxation services which, when provided to an audit or review client, may impair the independence of the member or firm. An example is when a member, a firm or a network firm represents an audit or review client before a court having jurisdiction to deal with tax matters.

### **Fees — Relative size**

190. When the total fees generated from an assurance client represent a significant proportion a member's or firm's total fees, the financial dependence on that about losing the client, may create a self-interest threat. The significance of the threat will depend upon factors such as:
- the structure of the firm; and
  - whether the member or firm is well established in practice.
- The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:
- taking steps to reduce the dependency on the client;
  - discussing the extent and nature of fees with the audit committee;
  - having firm policies and procedures to monitor and implement quality control of assurance engagements;
  - involving another member of the firm who is not on the engagement team to review the work done or advise as necessary;
  - arranging for external quality control reviews; and
  - consulting a third party, such as a professional regulatory body or a professional colleague who is not a member of the firm.

### **Fees — Overdue**

191. A self-interest threat may exist if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant portion is not paid before the issue of the

assurance report for the following year. Generally the payment of such fees should be required

before that report is issued. The following safeguards may be applicable:

- discussing the level of outstanding fees with the audit committee; and
- involving another member of the firm who is not part of the engagement team, or a professional colleague who is not a member of the firm, to provide advice or review the work performed.

Members are cautioned that the overdue fees might create the same threats to independence as a loan to the client. Therefore, members should consider whether, because of the significance of such threats, it is appropriate for the firm to retain the client.

## **Pricing**

192. Rule 204.4(34) provides that a member or firm may not provide an assurance service at a fee level that the member or firm knows is significantly lower than that charged by the predecessor member or firm, or contained in other proposals for the engagement, unless the member or firm can demonstrate that the engagement will be performed properly by qualified staff and in accordance with all applicable professional standards.

## **N. COMPENSATION OF AUDIT PARTNERS**

193. Compensating an audit partner for selling non-assurance services to an audit or review client of that partner may create a self-interest threat. The significance of the threat will depend on such

factors as:

- the structure of the firm;
- the size of the fee for the assurance service; and
- the size of the fee for the non-assurance service.

The significance of the threat should be evaluated and, if it is other than clearly insignificant,

safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- discussing the nature and extent of the fees with the audit committee;
- having firm policies and procedures to monitor and implement quality control of assurance engagements;
- involving another member of the firm who is not a member of the engagement team to review the work done or advise as necessary; and
- being subject to external practice inspection.

### *Audit clients that are listed entities*

194. Rule 204.4(35) provides that a member who is an audit partner of a firm with five or more audit clients that are listed entities or ten or more partners, may not earn or receive compensation based on the partner procuring engagements from a listed entity audit client of the partner to provide any product or service other than an assurance service. Rule 204.4(35) does not apply to partners who are not “audit partners” as defined.
195. The prohibition from compensating an audit partner for procuring or selling non-assurance services is not extended to compensation for performing such services and does not preclude an audit partner from sharing in the profits of the audit practice and the profits of the firm. An audit partner’s evaluation may take into account a number of factors directly or indirectly related to selling services to an audit client that is a listed entity. For example, an audit partner may be evaluated on the complexity of his or her engagements, the overall management of the relationship with the client including the provision of non-audit services, and the attainment of specific sales goals.

## **O. CONTINGENT FEES**

196. Members and firms are referred to Rule 215 and the related Council Interpretation.

## **P. GIFTS AND HOSPITALITY**

197. Rule 204.4(36) provides that a firm, or a member or a student who is part of an engagement team for an assurance client, may not accept a gift or hospitality, including a product or service discount, from the client unless the gift or hospitality is clearly insignificant to the firm or person as the case may be.

## **Q. ACTUAL OR THREATENED LITIGATION**

198. Actual, threatened or prospective litigation between a firm or a member of an engagement team and the assurance client or a shareholder or creditor of the client may create a self-interest or intimidation threat. The relationship between client management and persons on the engagement team should be characterized by complete candour and full disclosure regarding all aspects of the client's business operations and all matters relevant to the client's financial statements. The firm and the client's management may be placed in adversarial positions by actual, threatened or prospective litigation, which could impair complete candour and full disclosure, and in this, or other ways, the firm may face a self-interest or intimidation threat. The significance of the threat will depend upon such factors as:

- the materiality of the litigation;
- the nature of the assurance engagement;
- the stage of the litigation; and
- whether the litigation relates to a prior assurance engagement.

The significance of the threat should be evaluated and, if it is other than clearly insignificant, safeguards should be applied to reduce it to an acceptable level. Such safeguards might include:

- disclosing to the audit committee the extent and nature of the litigation;
- removing from the engagement team any person involved in the litigation; and
- involving an additional member of the firm who is not part of the engagement team to review the work done or advise as necessary.

If such safeguards do not reduce the threat to an acceptable level, the only appropriate action is for the member or firm to withdraw from, or refuse to accept, the assurance engagement.

199. Members are cautioned that actual litigation often results in a conflict of interest between the client and the member or firm which will preclude the member or firm from continuing to provide professional services to the client. Threatened or prospective litigation can have the same result. When faced with threatened, prospective or actual litigation, members and firms should refer to Rule 210 and the related Council Interpretation, and consult with their legal counsel, to determine whether they can continue to provide professional services to the client and, if so, whether there are particular arrangements which should be made with the client.

## **CI 204.6 MEMBERS TO ENSURE COMPLIANCE BY PERSONS ASSOCIATED WITH THE FIRM**

Members of the firm include all those persons who are associated with the firm in carrying out its activities. Members of the firm, including employees, who are not subject to the Institute's Rules of Professional Conduct could have an interest or relationship or provide a service that would result in the firm being prohibited from performing a particular engagement. Rule 204.6 requires a member who is a partner or proprietor of a firm to ensure that the firm and all members of the firm, including those who are not members of the Institute, do not have a relationship or interest, do not perform a service and remain free of any influence that would preclude the firm from performing the engagement pursuant to Rules 204.1, 204.2, 204.4 or 204.7.

## **CI 204.7 INSOLVENCY ENGAGEMENTS**

### **Member acting as trustee under the Bankruptcy and Insolvency Act, or as liquidator, receiver or receiver/manager.**

1. Rule 204.7 deals with objectivity and independence in insolvency practice. This interpretation sets out how, in Council's opinion, a reasonable observer might be expected to view certain situations related to insolvency practice.
2. A firm and a member, or member of the firm, and their respective immediate families, should not acquire directly or indirectly in any manner whatsoever any assets under the administration of the member or firm, provided that any of the foregoing may acquire assets from a retail operation under administration of the member or firm where those assets are available to the general public for sale and that no special treatment or preference over and above that granted to the public is offered to or accepted by the firm, the member or the member of the firm and their respective immediate families.
3. A member or firm should avoid being placed in a position of conflict of interest and, in keeping with this principle, should not accept any appointment:
  - (a) which is prohibited by law, or
  - (b) as a receiver, receiver-manager, agent for a secured creditor, or liquidator, or any appointment under the Bankruptcy and Insolvency Act, except as an inspector, in respect of any insolvent person or corporation, where the member or firm is, or at any time during the two-year period described in commencing at the date of the last audit report or the last review engagement report was:
    - (i) related to such person or corporation, or
    - (ii) the auditor or accountant of such person or corporation.

For purposes of this Interpretation the term "accountant" means any member or firm who has prepared unaudited financial statements in accordance with "Public Accountant's Review of Financial Statements," Section 8200 of the *CICA Handbook — Assurance*.

4. Where a conflict of interest may exist, or may appear to exist, a member or a firm should make full disclosure to, and obtain the written consent of, all interested parties and, in keeping with this principle, should not accept any appointment:
  - (a) as trustee under the Bankruptcy and Insolvency Act where the member or firm has already accepted an appointment as receiver, receiver-manager, agent of a secured creditor, liquidator, trustee under a trust indenture issued by the bankrupt corporation or by any corporation related to the bankrupt corporation, or on behalf of any person related to the bankrupt without having first made disclosure of such prior appointment. The member or firm should inform the creditors of the bankrupt of the prior appointment as soon as reasonably possible;
  - (b) as receiver, receiver-manager, agent for a secured creditor or on behalf of any person related to the bankrupt where the member or firm has already accepted an appointment

as trustee under the Bankruptcy and Insolvency Act without first obtaining the permission of the inspectors of the bankrupt estate. Where inspectors have not been appointed at the time that the second appointment is to be taken, the member of firm should obtain the approval of the creditors of the bankrupt of having taken the second appointment as soon as reasonably possible; and if the second appointment is taken before obtaining the approval of the creditors, it should be taken subject to their approval;

- (c) as receiver, receiver-manager, agent for a secured creditor or trustee under the Bankruptcy and Insolvency Act in respect of any corporation where the member or firm is, or at any time during the two-year period commencing at the date of the last audit report or the last review engagement report was, the trustee (or related to such trustee) under a trust indenture issued by such corporation or by any corporation related to such corporation without first obtaining the permission of the creditors secured under such trust indenture. Upon the acceptance of any such appointment as trustee under the Bankruptcy and Insolvency Act, the member or firm should inform the creditors of the bankrupt corporation of the prior appointment as (or relationship to) the trustee under a trust indenture issued by the bankrupt corporation or by any corporation related to the bankrupt corporation as soon as reasonably possible;
  - (d) as receiver, receiver-manager, agent for a secured creditor, liquidator of an insolvent company under the Winding-Up and Restructuring Act, or trustee under the Bankruptcy and Insolvency Act in respect of any corporation where the member or firm is related to an officer or director of such corporation; or
  - (e) as receiver, receiver-manager, agent for a secured creditor, or trustee under the Bankruptcy and Insolvency Act in respect of any person or corporation where the member or firm is a creditor, or an officer or director of any corporation that is a creditor, of such person or corporation unless the relationship is sufficiently remote that the member or firm can act having independence in fact and appearance.
5. For purposes of paragraphs 3 and 4, persons are related to each other if they are defined as such under Section 4 of the Bankruptcy and Insolvency Act.
6. A member or firm engaged in insolvency practice should ensure there are no relationships with retired partners which may be seen to impair the member's or firm's independence. Refer to paragraph 29 of the interpretations in respect of Rules 204.1 to 204.6.

## **CI 204.8 INDEPENDENCE - DISCLOSURE OF IMPAIRMENT OF INDEPENDENCE**

### **Professional services, other than assurance or specified auditing procedures and insolvency engagements**

1. Members and firms who provide a professional service which does not require the member or firm to be independent are required by Rule 204.8 to disclose any activity, interest or relationship which, in respect of the professional service, would be seen by a reasonable observer to impair the member's or firm's independence. Members and firms should refer to Rules 204.1 to 204.7 and the related Council Interpretations when determining whether they must be independent and would appear to be independent with respect to particular engagements.
2. Such disclosure is required whether or not any written report or other communication is provided and should indicate the nature of the activity or relationship and the nature and extent of the interest. Any written communication concerning or accompanying financial statements or financial or other information must include such disclosure.
3. Independence is not required for compilation engagements. Where the provider of the compilation service may be seen to be lacking independence, the disclosure requirement of Rule 204.8 applies.
4. For the purpose of Rule 204.8 the preparation of accounting records or journal entries in connection with a compilation engagement is not an activity that requires disclosure in the Notice to Reader unless such preparation involves complex transactions as contemplated by paragraph 143 of the Council Interpretations to Rule 204.1 to 204.6.
5. Tax return services may require disclosure in respect of some of the information filed with the return. If the return is simply the assembling and reporting of information provided by the taxpayer, then the member or firm involved has simply processed that information and disclosure should not be necessary.
6. Members and firms are cautioned that disclosure under Rule 204.8 does not relieve them from their obligation to comply with the rules of professional conduct and in particular Rules 201, 202, 205 and 206.

## **CI 205—FALSE OR MISLEADING STATEMENTS**

A member who is employed other than in public practice is subject to Rule 205 just as is the member in public practice. It is recognized that under exceptional circumstances, this may place such a member in a difficult position vis-a-vis the organization with which he is employed; however, a member fails in his professional duty if he allows himself to be associated with financial statements or other documents which he knows, or should know, are false or misleading.

## **CI 206—COMPLIANCE WITH PROFESSIONAL STANDARDS**

## Generally accepted accounting principles

1. The term “generally accepted accounting principles” has the meaning contained in the *CICA Handbook*. Some entities will prepare financial statements in accordance with other bases of accounting, including, for example, accounting principles generally accepted in another jurisdiction or accounting principles applicable to public sector bodies. In cases such as these, the term “generally accepted accounting principles” refers to the accounting principles that are required in the particular circumstances.
2. Compliance with Rule 206 necessarily involves the exercise of professional judgment in determining whether financial statements are presented fairly in accordance with generally accepted accounting principles. In this regard, the member [or firm] should refer to the *CICA Handbook – Accounting*, and in particular *Section 1100 “Generally Accepted Accounting Principles”*, and should ensure that the principles are applied in consideration of the spirit and intent of the pronouncements of the Accounting Standards Board and other primary sources of generally accepted accounting principles.
3. Where no primary source of generally accepted accounting principles exists, the member [or firm] should conduct such research and consult such authoritative sources and experts as are necessary in the circumstances to ensure that the presentation is consistent with generally accepted accounting principles. Members [and firms] should note that Paragraph .31 of *CICA Handbook Section 1100* states “ Sometimes a practice has been established that does not result from written material. The relevance of such a practice would be demonstrated by its compliance with paragraph 1100.04 and not by its use generally or within a particular industry. Extreme interpretations of a source do not constitute evidence that the criteria in paragraph 1100.04 have been met if it is likely that most parties, exercising professional judgment, would reject them as not resulting in a fair presentation in accordance with GAAP of the financial position, results of operations or cash flows of the entity.”
4. Members [and firms] should document the results of research undertaken and any other considerations influencing the member’s choice or acceptance of accounting policies and interpretation of generally accepted accounting principles.

## Practice of Public Accounting

5. Rule 206.1 requires a member [or firm] engaged in the practice of public accounting to perform professional services in accordance with generally accepted standards of practice of the profession. Generally accepted standards of practice of the profession include, but are not limited to the following:
  - the standards and guidance contained in the *CICA Handbook*;
  - the governing legislation, bylaws, regulations and rules of professional conduct of the provincial institute(s) to which the member or firm belongs; and- requirements of relevant federal and provincial statutes.
6. Members engaged in the practice of public accounting should foster an environment within their firms that encourages the discussion and understanding of the application of accounting principles and other standards of practice of the profession and provides for a process to deal with professional dissent. Members should encourage others within the firm who disagree with the application of those principles and standards in a particular situation to communicate that disagreement to an individual in the firm designated for that purpose.

7. A member who is responsible for issuing an assurance report on an entity's financial statements and who believes that the financial statements prepared by the entity's management are not presented fairly in accordance with generally accepted accounting principles should refer to the guidance contained in the *CICA Handbook - Assurance* and
  - (a) take those steps that are necessary to ensure that the financial statements are presented fairly in accordance with generally accepted accounting principles; or
  - (b) issue a report with an appropriate reservation, as required by the *CICA Handbook - Assurance*; or
- (c) seek permission to resign from the engagement.
8. A member who participates in an engagement to provide assurance on the financial statements of an entity and who believes the financial statements of the entity are not presented fairly in accordance with generally accepted accounting principles should communicate that belief to the person responsible for the assurance engagement. If, after consultation, the member continues to believe that the financial statements have not been presented fairly in accordance with generally accepted accounting principles, the member should communicate that belief to one of the firm's senior partners. Where possible, the communication should be dated and issued prior to the issuance of the financial statements and should be retained by the member for a reasonable period of time.
9. Before communicating with one of the firm's senior partners, the member referred to in Paragraph 8, should consider:
  - (a) whether the concern results in a material misstatement of the financial statements;
  - (a) whether the member possesses sufficient expertise and knowledge of the circumstances; and
  - (b) whether the member should first discuss the matter with another person in the firm.

### **Preparation of Financial Statements**

10. It is management's responsibility to ensure that an entity's general-purpose financial statements are presented fairly in accordance with generally accepted accounting principles. A member who has the final responsibility for determining management's application of accounting principles in the entity's general purpose financial statements must take effective steps to ensure that the entity follows generally accepted accounting principles. In doing so, the member may obtain advice and counsel from others.
11. Rule 206.2 applies to those members who have responsibility for or oversight of the application of accounting principles in the preparation of an entity's general-purpose financial statements. In some cases, a member's responsibility or oversight may be limited to a component of the financial statements, in which case Rule 206.2 applies to that member in respect of the accounting principles applicable to that component of the financial statements as well as to the member who has final responsibility for determining management's application of accounting principles to the general-purpose financial statements of an entity, taken as a whole. The member who has the final responsibility for determining management's application of accounting principles to the general-purpose financial statements of an entity is responsible for the application of accounting principles in respect of each component of the financial statements and cannot claim undue reliance on the opinion of the member having responsibility for or oversight of a particular component of the financial statements.

12. A member who has participated in management's application of generally accepted accounting principles to all or a portion of the financial statements and who believes the general-purpose financial statements of the entity have not been presented fairly in accordance with generally accepted accounting principles should communicate that belief to the person who has final responsibility for determining management's application of accounting principles. If, after consultation, the member continues to believe the presentation is not appropriate, the member should communicate that belief to the entity's audit committee or, where there is no audit committee, the board of directors. Where possible, the communication should be dated and issued prior to the approval of the general-purpose financial statements by the audit committee or the board, as the case may be.

The member should also communicate that belief to the person responsible for providing assurance on the financial statements. Before communicating with the entity's assurance provider, the member should consider obtaining legal advice.

13. Before communicating with the audit committee, board of directors or the entity's assurance provider, the member referred to in Paragraph 11 should consider matters including:

- (a) whether the concern results in a material misstatement of the financial statements;
- (b) whether the member possesses sufficient expertise or knowledge of the circumstances; and
- (c) whether the member should first discuss the matter with a more senior employee of the entity.

14. A member may prepare or approve financial statements that are not, and are not intended to be, presented in accordance with generally accepted accounting principles. Rule 206.2 does not apply when a member prepares or approves financial statements, which are

- (i) prepared solely for internal use within the entity; or
  - (ii) prepared for specified users under the terms and according to the accounting principles agreed to by the preparer and the specified users.
- Such financial statements are not general-purpose financial statements.

### **Service on audit committees and boards of directors**

15. A member who sits on an entity's audit committee or board of directors is expected to use the professional skills and knowledge that a competent Chartered Accountant would possess in fulfilling the member's responsibilities on such committee or board. Competency in the Chartered Accountancy profession is not static and cannot be defined without regard to time and context. Whether a member is competent is necessarily a question of fact at a point in time. Competency does not require a member who sits on an audit committee or board of directors to be an expert in financial accounting and reporting matters; nor does it require the member to act as a professional advisor to the audit committee or board. However, as noted below, it does require the member to identify and raise the issues that should be discussed by the audit committee or board of directors, as noted below.

A member who sits on an audit committee or board of directors should encourage the audit committee or board of directors to have substantive discussions with management and with the entity's assurance provider. Section 5751 of the *CICA Handbook*, in addition to setting

out requirements for auditors, provides useful guidance on the role that members of the audit committee or board members can play in the oversight of an entity's financial reporting process.

Matters that members who sit on an audit committee or board or directors should discuss with management and the assurance provider are the issues that a competent Chartered Accountant would raise, which include, but are not limited to:

- (a) the issues involved, and related judgments made by management, in selecting accounting policies and formulating significant accounting estimates and disclosures;
- (b) any disagreement within management or between management and the assurance provider with respect to the application of generally accepted accounting principles and the resolution thereof;
- (c) the assurance provider's conclusions regarding the reasonableness of the estimates made by management and the bases therefor; and
- (d) the independence of the assurance provider.

In addition to the above, a member who sits on an entity's audit committee or board of directors should take reasonable steps to ensure the audit committee or board of directors discusses with management the overall performance of the assurance provider.

Members who are directors of entities should be familiar with the applicable requirements of regulatory bodies and other authoritative pronouncements on corporate governance matters.

### **All members**

16. Members are also reminded of their obligations under the rules:
- (a) to bring to the attention of the Institute any information concerning an apparent breach of the rules of professional conduct or any information raising doubt as to the competence, reputation or integrity of another member (Rule 211.1); and
  - (b) not to sign or associate with any financial statement that the member knows, or should know, is false or misleading (Rule 205).

## **CI 209—BORROWING FROM CLIENTS**

1. It is a fundamental principle of the profession that members, students and firms provide advice to their clients that is free of prejudice, conflict of interest or undue influence that may impair sound professional judgment. When a member, student or firm borrows money from a client, there is an inherent conflict between the interests of the member, student or firm and those of the client. As provided in Rul 210.3(b), a member or student may borrow from a family member or an entity over which a family member exercises significant influence because the client's knowledge of the conflict and consent to provide the service may be implied by the client's conduct.

2. Member, students and firms are referred to Rules 204.4(10) to 204.4(12) and paragraphs 83 to 88 of the related council interpretations with respect to loans and guarantees to or from assurance clients.

3. When a member or student borrows money from or has a loan guaranteed by a client who is a family member or an entity over which a family member exercises significant influence, the member or student should consider setting out the terms and conditions of the loan or guarantee in writing. Before

the loan or guarantee is made, the member or student should also consider advising the client to obtain independent advice with respect to the matter. Similar considerations should apply when a firm borrows money from or has a loan guaranteed by a family member of a partner or shareholder of the firm or an entity over which a family member of a partner or shareholder of the firm exercises significant influence.

4. For purposes of Rule 209.1(b), a family member means any of the following person

(a) a spouse (or equivalent); or

(b) a parent, child, sibling, grandparent, grandchild, aunt, uncle, niece, nephew, or first cousin who is related to the member or the member's spouse (or equivalent) by blood, marriage or adoption.

5. Rule 209.1 applies only to new borrowings or guarantees or amendments to the terms of existing borrowings or guarantees that occur after the lender becomes a client. When an existing lender or guarantor becomes a client, the member, student or firm should be mindful of the need to provide services with due care and an objective state of mind and, accordingly, should consider whether the loan should be repaid or the guarantee released.

6. Rule 209.1 does not apply to amounts received from a client as a retainer or as a deposit on account of future services to be provided by the member, student or firm.

7. Rule 209.1 does not apply to a loan received from a member or student's employer.

8. Rule 209.1 does not apply to a bona fide business venture with a non-assurance client regardless of the method of financing the venture. However, members, students or firms that enter into such ventures are cautioned that they must comply with all of the other Rules of Professional Conduct including, but not limited to:

- |     |     |   |  |
|-----|-----|---|--|
| i   | 201 | - | Maintenance of reputation or profession; |
| ii  | 202 | - | Integrity and due care;                  |
| iii | 204 | - | Independence                             |
| iv  | 208 | - | Confidentiality of information; and      |
| v   | 210 | - | Conflict of interest                     |

## **CI 210 — CONFLICT OF INTEREST**

### **Identifying Conflicts**

1. Rules 210.1 and 210.2 together require members to determine whether there exist conflicts as between themselves and their clients or proposed clients, or between the duties and obligations owed to one client and the duties and obligations owed to another client or a proposed client. Where such a conflict is found to exist, the member must decline to act in the proposed affected engagement, or withdraw from the engagement, unless the consent of the client or proposed client to proceed or continue the engagement is implied by the client's or proposed client's conduct or the conflict can be managed as provided in Rule 210.3(a).

2. Conflicts in a member's firm or practice generally arise in three broad types of circumstance described as follows.

#### *Protecting Confidentiality of Client Information*

3. As provided in Rule 208 and the related Council Interpretation, members and students must protect the confidentiality of client information and assure clients that this information will not be disclosed. The only exceptions to this obligation are set out in the Rule itself.

#### *Pursuit of Clients' Interests*

4. Members and students have an obligation to all of their clients to provide professional service with integrity and due care. Since members and their firms will have a number of clients, they may encounter conflicting client interests when fulfilling their obligations to each client. While a member or firm may be able to provide services to clients whose interests conflict, they must consider the extent of their obligations to each client and then use professional judgment to determine whether any particular conflict must be avoided, or whether explicit consent must be obtained or the situation reflects common commercial practice where the consent of the client to act is implied by the client's conduct. Where there is explicit or implied consent, the member or firm must also consider whether the conflict can be managed appropriately.

#### **Common Commercial Practice**

5. The following situations involve implied consent and reflect common commercial practice:

*"The firm is acting as auditor for several clients who happen to compete in the same industry. They have hired us for our experience with their industry, and respect our reputation for protecting confidential information."*

It is reasonable for members to conclude that clients with knowledge of the circumstances who do not object to a conflict at the outset of an engagement have accepted the conflict.

*"I am doing an audit for Company XYZ and they have asked me to do some consulting as well. As an assurance provider, my duty is to report to the shareholders. As a consultant engaged by management, my duty is to the corporation."*

Members must be aware of the implications to their objectivity and independence when providing consulting services to an assurance client.

#### **Other Conflicts**

##### *Appropriate Management of Conflicts*

6. There will be instances where a conflict will arise that can be appropriately managed provided the circumstances are clear to all parties and there is explicit consent on the part of all parties to proceed.
7. The following conflict situations may or may not be acceptable to the public:

*“I would like to call upon an expert within my firm to assist on a particular matter for one of my clients. This expert is already committed to another client.”*

Whether this situation creates a conflict depends on many factors, including the number of experts in the firm.

*“The firm has two separate clients who have asked it to take on a merger and acquisition assignment—however, each client is focused on acquiring the same target company.”*

Whether this situation creates a conflict depends on the ability to use distinct teams on each engagement and the effectiveness of procedures put in place to safeguard confidential client information.

There is a rebuttable presumption that the following conflict situations are unacceptable and, if the presumption is not rebutted, must be avoided:

*“The firm has been asked by the husband and 50% shareholder of the firm’s client, Company X, for assistance in purchasing the shares of the other 50% shareholder (his wife) in settling the distribution of assets in a divorce settlement.”*

*“The firm has been asked to complete a merger and acquisition assignment for my client but the takeover target is already a client (or former client) of the firm.”*

*“The firm is conducting a job search engagement for a client. I have found an excellent candidate to fill the position—only this candidate is currently employed by one of our firm’s clients.”*

*“I have been asked to pursue a strategic marketing study for one of my clients—however, the firm is already undertaking a similar marketing study for another client in the same market.”*

Whether this final example is a conflict that can be managed will depend on the ability of the firm to use appropriate institutional mechanisms on the two engagements.

### **Conflicts Encountered by Professional Service Area**

8. Institute members who are also members of another professional body must also adhere to that other body’s code of conduct. Other professional bodies would include, among others, the Canadian Association of Insolvency and Restructuring Professionals, the Canadian Institute of Business Valuators and the Canadian Institute of Actuaries. Where the Institute’s rules differ from those of the other professional body, the higher of the two standards will apply.

9. It is possible that the nature of an engagement may change during the course of the engagement. This is particularly true when a member is asked to conduct an engagement in a situation that is potentially adversarial, even though the parties who engage the member may be in accord initially. Therefore, members must consider the possible existence and management of conflicts throughout the course of the engagement.
10. The following is a discussion of conflicts of interest commonly encountered by members and their firms in the significant areas of professional practice.

#### *Assurance Services*

- (a) A member or firm may be asked to provide assurance services for two or more clients who have competing commercial interests. There will either be implied consent on the part of all clients for the member or firm to act or the assurance provider will deal with the conflict by obtaining the informed consent of each client. In either case, the member should use procedures to protect confidential client information.
- (b) A member may possess confidential information obtained from one assurance client that is important to the fulfillment of the assurance engagement of a second client. For example, a member may learn during the course of an assurance engagement that the assurance client is in serious financial difficulty. If the member also undertakes an assurance engagement for a major supplier of the assurance client, the member will possess confidential information that could result in a material change to the financial statements of the supplier-client. The member may not rely on this confidential information to complete the engagement for the supplier-client. If the supplier-client is unaware of the information relating to the first client, the member has a conflict of interest that must be resolved.

In such circumstances, the member is expected to use reasonable efforts to obtain the confidential information from other sources, and if this is not possible, the member should seek legal advice.

- (c) A member may possess confidential client information gained in the course of an assurance engagement that would be useful in the provision of other professional services by the firm. Such confidential client information obtained in the course of the assurance engagement must be protected from disclosure or use for other purposes unless prior permission is obtained from the client.
- (d) An assurance provider has the right to obtain the information that is required in order to carry out the assurance engagement. For this reason, the assurance provider is expected to have all knowledge concerning the client that the firm possesses that is relevant to the assurance engagement. Clients are expected to give assurance partners the information directly but may authorize assurance partners to seek out the information from others within the firm. Information protected by legal privilege would be dealt with by following the protocol for enquiries established by the lawyers involved.
- (e) A member or firm engaged to provide an assurance report to the shareholders on a set of financial statements might be asked by one shareholder for confidential client information from the audit working papers to be used by that shareholder in a dispute with another shareholder. Since the assurance provider's duty is to the

shareholders as a group and not to individual shareholders, such a request would present a conflict.

- (f) Members and firms should refer to Rule 204 and the related Council Interpretation for guidance on conflicts that may affect independence and objectivity with respect to an assurance engagement.

#### *Taxation Services*

- 11. (a) A tax practitioner is likely to be involved in providing tax assistance and advice to a wide variety of clients who are entitled to expect their affairs to be kept confidential. The tax practitioner is expected to provide each client with the benefit of all of his or her professional knowledge unless the practitioner and the client agree, preferably in writing, that particular knowledge that the practitioner possesses may not be disclosed to third parties because it is proprietary to the client. Other clients should be made aware that this restriction might exist from time to time.
- (b) A member or firm may be asked to provide tax-planning advice to two clients who will use that advice to pursue an objective that only one of them can achieve. Since both of the clients are in pursuit of the same objective, there is an initial presumption that the firm can accept only the first request to act in the matter. It may, however, be possible for different persons within the firm to act for each client through the use of effective institutional mechanisms, thus rebutting the initial presumption that the firm cannot serve both clients.
- (c) A tax practitioner may obtain only the information that relates to his or her specific engagement. In such a case, it is reasonable to believe that the tax practitioner will not possess all of the firm's knowledge of a particular client and it may be possible to satisfy the onus of demonstrating that the firm's knowledge is not automatically shared by the particular tax practitioner.

#### *Management Consulting Services*

- 12. A management consultant may be involved in a variety of engagements such that there are conflicts which may be acceptable in one type of engagement but which are unacceptable in another. Since consulting engagements usually have clearly stated objectives and a defined life span, the issue of possible conflicts of interest is often dealt with in the terms of the engagement (i.e., the extent of the member's obligations are agreed to by contract).
- 13. Consulting engagements may be generally regarded in three categories for the purpose of considering the issue of conflict of interest, as follows:
  - (a) Process and design consulting engagements, which generally involve the provision of specialized knowledge to assist a client to achieve an objective that the client has chosen. It is usual for a consultant to provide such assistance to a wide range of clients, some of whom may have competing interests. Often, the consultant is selected for specialized expertise. The clients recognize that, in the future, the consultant is likely to make that expertise available to others, having built on experience gained along the way.

- (b) Strategic consulting often involves a consultant assisting a client in the selection of

optimum business strategies. Strategic consulting is likely to involve the most highly sensitive and confidential business information. Consultants providing these types of services typically recognize this sensitivity and do not work for clients who are in direct competition. It is, however, recognized that the business strategies selected often become publicly known within a short time frame and it is therefore possible that, after a suitable time, a consultant may undertake work for a direct competitor of a previous client. Such matters should be expressly addressed in the engagement contract.

- a) Search consulting involves assisting a client to locate information or resources that are necessary for the client to attain an objective. Since the information or resource is likely to exist within another commercial enterprise, the opportunity for a conflict of interest to arise is particularly great. For this reason, it is customary for the consultant to disclose at the outset the nature and extent of any limitations on the scope of the search.

#### *Merger/Acquisition Services*

- 14. (a) A practitioner involved in merger and acquisition activity is likely to be involved in a number of such engagements concurrently working for both existing and new clients. Where the practitioner is a member of a firm there may be several types of specialized support which the firm will offer in this area of activity ranging through due diligence, tax planning, market analysis and pricing of the proposed transaction.

A member involved in mergers and acquisitions is expected to use a variety of conflict management tools to provide the greatest possible assurance that confidentiality of the work will be maintained unless otherwise agreed with the client. A firm will be expected to regularly employ Fire Walls and to impose Cones of Silence on those who are consulted in the work. Where consultations beyond the firm are required, the use of confidentiality agreements will be necessary.

- (b) Due to the nature of the work of a merger and acquisition practitioner, it is recognized that the pursuit of an engagement for one client may run contrary to the interest of another client of the firm.

When a firm uses institutional mechanisms such as Fire Walls, it should be recognized that if their use is challenged in a court of law, the firm will be required to demonstrate that the institutional mechanisms are effective. Even then, when one or more of the firm's merger and acquisition practitioners are working for clients pursuing approximately the same objective within approximately the same time frame, the firm, with the permission of each client, is expected to obtain the informed consent of all such clients, ordinarily in writing. While able to provide advice, unless agreed otherwise by all clients, the firm should exclude itself from the client's decision-making role.

#### *Forensic Accounting & Litigation Support Services*

- (a) A forensic practitioner may engage in a number of different types of activity that will involve different expectations from a client. The most common different circumstances are finder of fact (including fraud investigations, breach of law

investigations), quantification of losses and expert accounting and auditing testimony (including where a firm employs other experts such as actuaries, engineers, and economists).

In almost all circumstances, there is the real possibility that an engagement will become part of a dispute. There is, therefore, the expectation that the member will respect the firm's obligations to its clients by not acting against them. This expectation may be modified in circumstances where the client engaged the firm for a narrow and unrelated purpose (such as a productivity improvement consulting assignment or an employee search assignment), but the member will only be able to rebut the presumption if it is clear the information received from the client is not relevant to the matter in dispute.

In the case of current clients, the firm may proceed with the engagement with the informed consent of both parties. The use of tools such as informed consent, Cones of Silence and Fire Walls will assist the firm to demonstrate that confidential information will be protected.

- (b) It would ordinarily be appropriate for a member or firm to act as a finder of fact for parties on the opposing sides of a conflict where both parties agree to use the fact finding report as an agreed statement of fact within the legal process.

#### *Valuation Services*

- 16. (a) A valuation practitioner may or may not be a chartered business valuator (CBV).  
Valuation practitioners recognize the need to avoid conflicts of interest by not acting for two or more clients whose interests may conflict, except after adequate disclosure to and with the express written consent of all parties.
- (b) Valuation practitioners must take care not to create a conflict of interest by accepting an engagement that will put them in a position of advocacy against another client or former client when the practitioner has confidential information of that former client. For example, a valuation practitioner should not accept an engagement from one shareholder group of a company that is being broken up (butterfly transaction) where the member has previously provided services to all shareholders of the company. Similar considerations also exist where the clients are a married couple who are divorcing.

#### *Actuarial Services*

- 17. A member who provides actuarial services may be a member of the Canadian Institute of Actuaries. Conflicts of interest should be less likely in actuarial assignments. However, when actuaries become involved in areas such as merger and acquisitions where conflicts frequently do arise, they are expected to conduct themselves as other members working in those areas.

#### *Insolvency Services*

- 18. A member who provides insolvency and corporate recovery services may be a licensed trustee and a member of the Canadian Insolvency Practitioners Association. Since much of

this work is carried out under the auspices of the court, there is a special set of rules to deal with potential conflicts in the various roles that a member may serve. Although these rules prevent members from serving roles for different classes of creditor, they do permit the grouping of creditors of a single class into one pool, even though some of these creditors may have conflicting interests.

## **The Process for Dealing with Conflicts of Interest**

### **Step 1: Identify Conflicts or Potential Conflicts**

19. In order to identify conflicts or potential conflicts when accepting a new engagement, a member should seek information from others within the firm as to the interests of other clients and their affiliations. While many conflicts are obvious from the beginning, other conflicts may arise during the course of an engagement. Often, identifying conflicts is more difficult than dealing with conflicts.

20. There are three types of conflict, which may overlap, described as follows.

#### *Professional Conflicts*

21. Members, students and others within their firms are required by the profession to observe the rules of professional conduct. In order to preserve the highest possible standards for the CA profession, each member is expected to engage only in activities that will maintain the good reputation of the profession and its ability to serve the public interest. When this obligation runs contrary to a client's interest, a professional conflict exists.

#### *Legal Conflicts*

22. Legal conflicts of interest arise primarily out of a member's client obligations or specific contractual agreements. A member and his or her firm have a duty within the standards of the profession to pursue the client's interests and to protect confidential client information. Thus, when two clients have conflicting interests, the firm cannot fulfill a duty to both unless appropriate institutional mechanisms are in place.
23. In addition, when a member is acting within the framework of litigation or potential litigation, the courts will want to ensure that the legal process is not compromised by participants, who act as experts, being influenced by interests or relationships which impair or might impair their objectivity.

#### *Business Conflicts*

24. Business conflicts occur when the business interest of a client is contrary to the business interest of the member or his or her firm or the business interest of another client of the member or firm. A business conflict raises management, not professional, issues for the member and his or her firm and can be resolved without reference to the rules of professional conduct, unless it also involves a professional or legal conflict. Business conflicts include the following examples:

- (a) a particular engagement may require too large a commitment of scarce resources in the firm;

- (b) the provision of certain services to a client may preclude the provision of other, more lucrative, services to the same client;
- (c) the firm is dissatisfied with the risk/reward analysis.

Each firm should develop a conflict identification process. This process should include a client information database and a system that allows for timely access to the database by members of the firm so that real or potential conflicts can be recognized promptly. Conflict inquiries should be documented. The client information database should be kept up-to-date, and should not include confidential client information.

- 25. A member who practises in an international partnership, or has an association with a firm or firms which have an international practice, will have to exercise professional judgment when deciding who should be consulted when seeking information about conflicts and possible conflicts. Consultation will normally be limited to the country or countries in which the particular engagement will be conducted unless the member is aware of the potential for conflicts arising in a broader geographical area. The nature of the partnership or association and the interests of the potential client are two factors the member should consider.
- 26. For areas of practice where conflicts must usually be avoided rather than managed, a firm's conflict identification process will likely need to be more extensive and formal and should include the identification of a person or persons in the firm to act above the wall as a conflict management officer or officers.
- 27. An effective conflict identification process will allow a firm to identify conflicts (or possible conflicts) early on in an engagement. The earlier a potential conflict is identified, the greater the chance the firm will be able to choose to manage the conflict, rather than avoid the engagement altogether.

### **Step 2: Assess the Conflicts**

- 28. After conflicts and possible conflicts have been identified, a member should exercise professional judgment as to whether the conflict must be avoided altogether by declining the engagement, or whether the conflict can be appropriately managed.
- 29. When assessing the conflict, members and others in a firm should consider the following questions.
  - (a) Is the conflict solely a business conflict such that it does not require any action under the rules of professional conduct?
  - (b) Is the conflict one where consent to proceed can be implied from the client's conduct, in keeping with common commercial practice, or is it necessary to obtain explicit consent?
    - (c) Does the conflict impair the member's or firm's independence and objectivity with respect to an assurance engagement?
    - (d) Does the conflict hinder the member's ability to perform his or her duties?
    - (e) What will be the impact on the client's ability to obtain professional services should the member or firm choose to decline the engagement? In smaller communities,

where there are fewer practitioners available to serve clients' needs, there may be more occasions when it is necessary to manage conflicts.

- (f) Would a reasonable person be satisfied that the proposed conflict management approach is satisfactory to manage the conflict?
  - (g) Is it likely the requested service will go before a court where another client of the firm will be an opposite party? Unless the member has been asked to act as a fact finder or is providing information that is not contested, a court is likely to find it unacceptable for a firm to represent two clients who are litigating against each other.
  - (h) Will the institutional mechanisms available to the member or the firm be effective in managing the conflict? This will be determined by the facts of the situation and the onus will be on the member or the firm, where necessary, to demonstrate to the courts that the institutional mechanisms are effective in protecting confidential client information.
  - (i) Will the member's or the firm's decision to avoid the conflict by resigning from the engagement be a commercially satisfactory solution for the client or clients in conflict? In many cases, the solution to avoid the conflict by resigning from the engagement with each of the clients will not be commercially satisfactory.
30. Once a member has identified a conflict and assessed its impact, he or she may decide to:
- (a) Decline/Terminate the Engagement - For those conflicts that are not possible or appropriate to manage, the member should inform the client that the engagement will be declined or terminated; or
  - (b) Develop an Effective Conflict Management Approach – For manageable conflicts, the next step is to develop an effective Conflict Management Approach. Members must be aware that the decision to manage a conflict may be subjected to challenge later; or
  - (c) Accept the Engagement - For those conflicts that, by reason of their common acceptance in practice, it is deemed not necessary to manage through special procedures or obtaining consent, no action is required before the engagement is accepted.
31. Generally, most decisions with respect to business conflicts of interest will be made by a member or the firm based on a desire to retain the confidence of and relationship with existing clients and potential clients and will generally not involve consideration of the rules of professional conduct. For this reason, a member or firm may decide to do work for competitors of a client; not to do work for a direct competitor of a significant client; or, to seek permission before providing a particular service to a competitor of a client.

### **Step 3: Develop a Conflict Management Approach**

32. Once the member or the firm has identified a conflict that is potentially manageable, the next step is to examine the various institutional mechanisms that are available within the firm to manage the conflict. A Conflict Management Approach is then developed, incorporating the

various institutional mechanisms selected. While no specific approach is prescribed, each Conflict Management Approach must be effective and the member or firm must be able to demonstrate that it is effective. The member should then provide disclosure to the affected client or clients and obtain client consent to proceed.

### **Choose the Institutional Mechanisms**

33. The following institutional mechanisms may be incorporated in an effective Conflict Management Approach.

#### *Firm Structure*

34. A firm may organize itself in a variety of ways to deal with conflict issues, such that the organization itself becomes an effective Conflict Management Technique. A firm should consider the adoption of some or all of the following conflict techniques as part of its organizational structure. It is noted that, depending on factors such as the size of a firm, not every technique will be appropriate for every firm:
- (a) Adopt Conflict Management Policies that provide firm members with guidance on dealing with conflicts. These policies should recognize the role of professional judgment in the process and require members of the firm to be able to demonstrate that the interests of their clients will be served at a high professional standard. The policies should also require that clients be informed as to what they should expect when agreeing to allow a firm with a conflict to act on their behalf.
  - (b) Implement an Engagement Reporting Structure that is overseen by a Conflicts Management Committee or by one or more persons within the firm. The role of the Committee or responsible person(s) is to (i) identify, at the outset, potential conflicts, and decide whether to avoid the conflict or manage it and (ii) be informed of possible conflicts and provide assistance to others within the firm on exercising professional judgment with respect to conflict management. The person(s) determining or managing a particular conflict should be above the wall with respect to that conflict.
  - (c) Create separate areas of practice for specialty functions within the firm, which may act as a barrier to the passing of confidential client information from one practice area to another within a firm. The flow of information from one area to another should be restricted by firm policies and procedures. Such policies and procedures would not preclude the cross-departmental sharing of information by members of a particular client service team. Within each separate area, members must understand the expected limitations in sharing confidential client information across areas. It is recognized that the larger and more complex the firm, the more likely the need for creating separate areas of practice.
  - (d) Establish policies and procedures to limit access to files. Much of the information obtained throughout the course of an engagement is retained in the files of the firm, either electronically or paper-based. To maintain the confidentiality of these files, a firm may put in place a formal system that limits access to these files to persons who are working directly on the engagement, logs access to files, and documents any access exceptions. The physical segregation of particular confidential information may further enhance its protection. Broad access to non-public

information that has been retained by a firm may be viewed by its clients as contrary to its responsibility to protect confidential information.

- (e) Use blanket or engagement-specific confidentiality agreements signed by employees, which will emphasize the need to protect confidential information.
- (f) In areas of practice where it is likely conflicts of interest will arise on a regular basis, use code names or numbers to assist in the use of Fire Walls and other conflict management tools.

### *Fire Walls*

35. The effectiveness of Fire Walls will be improved by the use of internal procedures such as designating an above the wall person to monitor the activities within the Fire Wall(s) and to ensure that the firm as a whole is not acting in an inappropriate manner. This person would:
- (a) ensure that the firm did not engage in activities that it was not appropriate or possible to manage;
  - (b) ensure that persons joining or leaving a team within the firm do not create new unacceptable conflicts;
  - (c) document the teams' respect for the wall; and
  - (d) avoid involvement in or detailed knowledge of information contained within the wall.
  - (e) Fire Walls should involve some combination of the following organizational arrangements:
    - (f) physical segregation of people and files;
    - (g) an educational program, normally recurring, to emphasize the importance of not improperly or inadvertently divulging confidential information;
    - (h) strict and carefully defined procedures for dealing with a situation where it is felt that the wall should be crossed, and maintaining proper records where this occurs;
    - (i) monitoring by compliance officers of the effectiveness of the wall; and
    - (j) disciplinary sanctions where there has been a breach of the wall.

### *Cones of Silence*

Cones of Silence may be used to:

- (a) demonstrate foresight of the need to maintain client confidentiality and thereby assist a firm to manage conflicts arising in various areas of its practice;
- (b) allow a firm specialist to work on a minor aspect of an engagement without being brought formally within a Fire Wall; and

- (c) demonstrate the commitment of those involved.

In some rare circumstances, a Cone of Silence is demonstrated implicitly by the special conduct of a member or another person in the firm. In such circumstances, there should be observable evidence that the Cone of Silence will be effective.

- 36. The limitations on the use of Firm Structure, Fire Walls and Cones of Silence must always be recognized and considered in terms of whether the firm's obligations to its clients can be fulfilled. A professional judgment must always be made in light of the particular facts and circumstances. Institutional mechanisms that are set up on an ad hoc basis, after a conflict is identified, will not be seen to protect confidential information that may already have been shared within a firm. Ongoing institutional mechanisms used on a regular basis are more likely to be effective and be seen to be effective than those set up on an ad hoc basis.
- 37. The uses of institutional mechanisms to restrict information flows between units or individuals within a firm may not be effective when:
  - (a) a client expects to have complete access to all of the firm's resources. The use of a Fire Wall to protect the interest of another client may not be acceptable to the client.
  - (b) a member or firm is not able to demonstrate clearly that they have been and will continue to be highly effective in preventing the sharing of confidential information.
  - (c) there is a single department, operating unit or a large number of people coupled with a high turnover rate within the wall.
  - (d) a member attempts to hide behind the wall. The existence of a Fire Wall does not relieve a member or firm from making the appropriate enquiries or exercising professional judgment.

### **Provide Disclosure and Obtain Client Consent**

- 38. A fundamental underpinning to the management of conflicts of interest involves informed consent by clients. Unless the conflict is one that reflects common commercial practice such that the client's consent can be inferred from the client's conduct, informed consent should be obtained by:
  - (a) notifying the client of the existence of a conflict; and
  - (b) either declining or resigning the engagement or obtaining the agreement from the client to proceed in spite of the conflict.
- 39. The onus is on the member or firm to be able to demonstrate that informed consent has been obtained. In cases where the conflict is one referred to in Rule 210.3(b), the informed consent must be implied by the client's conduct and acceptance of the circumstances. In all other cases, it is desirable to obtain informed consent in writing. When written consent is not obtained, the client's verbal consent and the details thereof should be noted in the member's or the firm's files. The more direct the conflict is between existing or

potential clients, the more important it is for the firm to ensure that the clients and potential clients know that their interests may conflict with the interests of other clients of the firm and that the firm has effective measures in place to ensure that confidentiality is maintained. In each case, members should use professional judgment in determining the nature and extent of disclosures required to be made to each client and the need to obtain consent in writing.

40. If notifying the client of the existence of a conflict would, in itself, constitute a breach of confidentiality, the member or firm will have no choice but to decline the engagement.
41. The appropriateness of managing a particular conflict is likely to depend on the particular facts and circumstances. As circumstances evolve, clients who initially agreed to allow a firm with a conflict to act may change their position. The risk and consequences of this possibility should be considered at the outset.
42. When a member enters into discussions with a client about the impact of possible conflicts on the client's interest, the member should specifically address how the obligations to the client will be met and what restrictions, if any, there will be on access to the expertise of the firm.
43. It appears that the courts will recognize the contractual clarification of a member's obligations by either express or implied terms along with disclosure and consent, for example:
  - (a) An engagement letter or contract may be used to clarify the member's and the client's obligations in an engagement. The following wording might be used to inform a client of potential conflicts in an engagement, restrictions that could apply and the use of institutional mechanisms to protect confidential client information:

*"We provide a wide range of services for a large number of clients and may be in a position where we are providing services to clients whose interests may conflict with your own. We cannot be certain that we will identify all such situations that exist or may develop and it is difficult for us to anticipate all situations that you might perceive to conflict. We therefore request that you notify us promptly of any potential conflict affecting the Contract of which you are, or become, aware. Where the above circumstances are identified by us or you and we believe that your interests can be properly safeguarded by the implementation of appropriate procedures, we will discuss and agree with you the arrangements that we will put in place to preserve confidentiality and to ensure that the advice and opinions which you receive from us are wholly independent of the advice and opinions that we provide to other clients. Just as we will not use information confidential to you for the advantage of a third party, we will not use confidential information obtained from any other party for your advantage."*
  - (b) Written expression in public policy statements of clarifications of obligations undertaken also appears to be a tool that a member or firm may use to further demonstrate the management of possible conflicts of interest.
  - (c) To the extent that the matter is not dealt with in the foregoing, clarification of a member's or firm's obligations may also be included in final reports, proposals, etc.

In the engagement letter, public policy statement or contract, the relationship may be clarified by:

- (a) Clearly defining the obligations owed to the other party. This may be accomplished through an exclusion clause;
- (b) Clearly delineating the rights and duties of all parties; and
- (c) Where a conflict is managed in part by a client's informed consent, including provisions that set out the consequences should the client terminate its consent. It might be agreed, for example, that in such circumstances the member or firm would (or would not) be able to continue to act for one of the other parties, and if so, which one.

#### **Step 4: Assess the Effectiveness of a Conflict Management Plan**

- 44. After choosing the institutional mechanisms that will be relied upon, the member should assess the overall effectiveness of the plan. The onus will be on the member or firm to be able to demonstrate that the institutional mechanisms are effective in protecting confidential client information. In a particular case, the court may not accept the use of institutional mechanisms to manage a conflict. Members must assess the risk of such a finding by a court on a case-by-case basis and, where appropriate, obtain legal advice.
- 45. When assessing the effectiveness of the selected institutional mechanisms, members should ask the following questions:
  - (a) Will the institutional mechanisms work effectively in practice? For example, it may not be possible to obtain the informed consent of two clients as the mere disclosure of the issue to one client might involve the disclosure of confidential information of the other client.
  - (b) Are the persons required to perform the work able to remain within a Cone of Silence or behind a Fire Wall for the required period of time?

#### **Step 5: Re-evaluate the Plan During Engagement**

- 46. A client relationship will often exist for an extended period of time during which the client's interests may change. When in the course of an engagement for a client, conflict or possible conflict with an engagement for another client is discovered, a member or firm should consider the following actions:
  - (a) resign from both assignments without disclosure of the detailed reasons if such disclosure would also disclose confidential client information; or with appropriate disclosure of the detailed reasons if confidential client information can be protected;
  - (b) obtain informed written consent from both clients to continue their engagements in spite of the conflicts;
  - (c) seek the informed written consent of both sides to continue for one side;
  - (d) after obtaining the required consent in (b) or (c), use existing institutional mechanisms such as Cones of Silence or Fire Walls, to protect confidential client

information in appropriate circumstances.

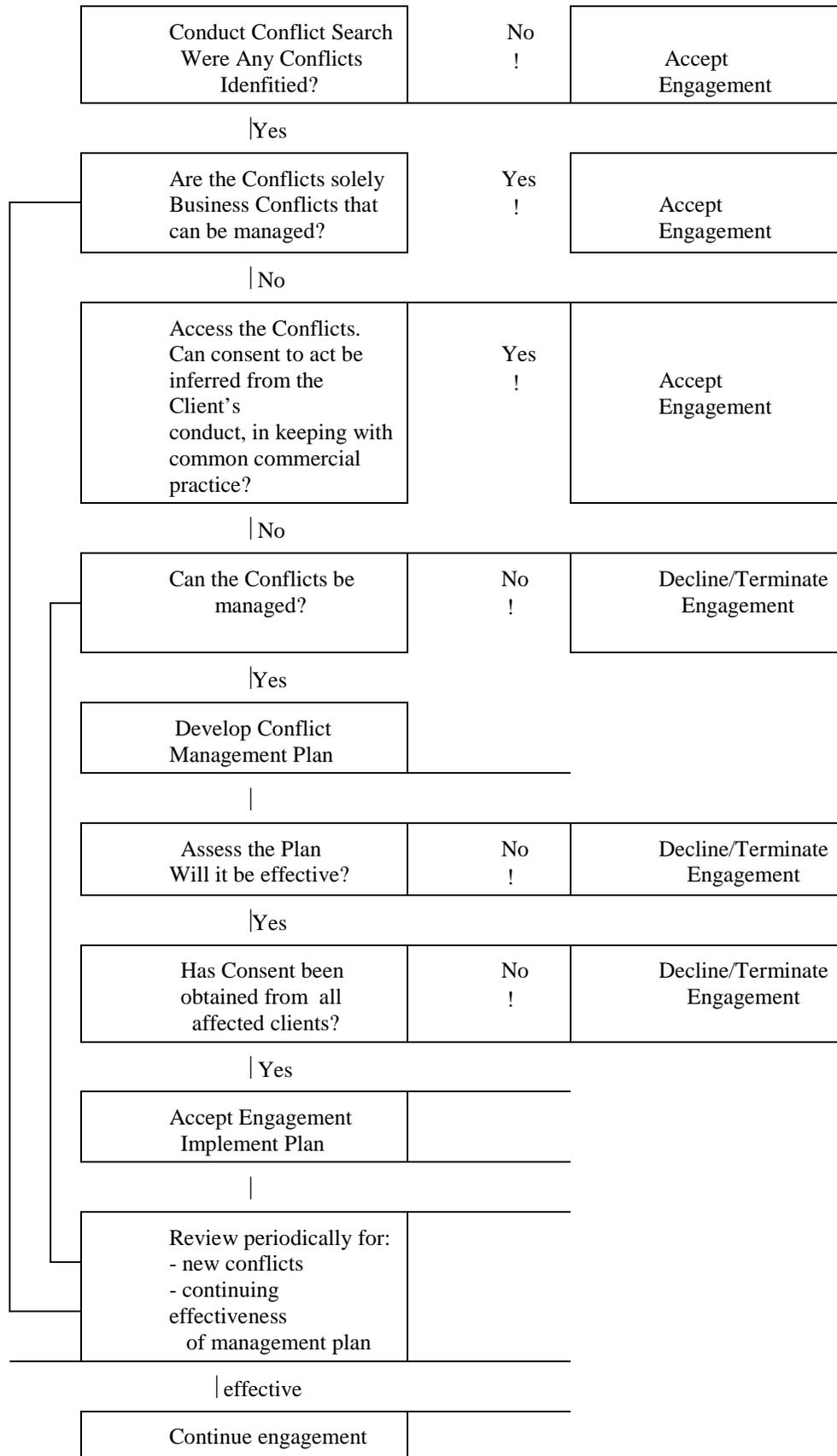
47. When the discovery of a conflict occurs while an engagement is in progress, it may be more difficult to then implement institutional mechanisms to protect confidential client information. It will also be difficult to clarify the firm's obligations by indicating that the firm intends to accept engagements for clients whose interests may from time to time conflict with those of existing clients.
48. If, however, institutional mechanisms such as Cones of Silence or Fire Walls have been in place from the outset of both client assignments, or clients have been informed at the outset of possible conflicts, the task of dealing with new conflicts that arise is made easier.

### **Documentation and Other Considerations**

49. Since problems with the management of conflicts may arise in the future, it is important to document the process by which conflicts are assessed and managed. Documentation will normally include considerations with respect to the identification of conflicts; the assessment of conflicts and the facts considered in making the assessment; the conflict management plan adopted with the reasons the member or firm believes the plan will be effective; and the ongoing assessment of the plan's effectiveness.
50. When developing a Conflict Management Approach, the firm must ensure that the Conflict Management Techniques selected are robust enough to demonstrate that the client's interest will be served within the terms of the engagement.
51. The use of such techniques requires the use of professional judgment since ultimately their effectiveness and acceptability will be judged using the standard of "the expectation of an informed, reasonable observer".
52. In those areas of practice where relationships or engagements exist for extended periods of time, the question of potential conflicts should be addressed at least annually, perhaps as part of the ongoing client continuance review.

### **Conflict Management Decision Chart**

**The process for dealing with conflicts may be illustrated by the following flowchart.**



1. It is in the public interest that a member be required to report to the Institute apparent breaches by another member of the rules of professional conduct. The good reputation of the profession could adversely be affected if such matters were not reported. Rules 211.1 and 211.2 are not intended to require a member to report trivial matters or minor perceived faults of another member. Each mistake or omission by a member is not necessarily a breach of the rules of professional conduct. In deciding when to report, a member should believe that the matter raises doubt as to the competence, reputation or integrity of another member.
2. Rule 211.1 sets out specific situations where it does not apply. For example, the rule does not apply to disclosure of information obtained by a member
  - (a) in the course of the member's employment by an organization, such as a government taxation authority, where there is a legal requirement imposed by statute to maintain the confidentiality of information obtained through this employment;
  - (b) in the member's role as a practice inspector or practice advisor, who has been exempted for the purpose and to the extent specified by Council;
  - (c) in the course of an engagement, such as a litigation support engagement, when disclosure will result in the loss of solicitor-client privilege.
3. Under certain circumstances, such as the forensic investigation of a fraud, Rule 211.2 permits the reporting of a matter to be delayed until
  - (a) the client has consented to the release of such information, or
  - (b) the information has become known to third parties other than legal advisors, or
  - (c) it becomes apparent to the member that the information will not become known to third parties other than legal advisors.
4. Rule 211.2 attempts to strike a balance between the member's duty to the client and the member's duty to protect the public interest and maintain the reputation of the profession. Clients may assume that a member will not disclose information without consent, resist the obligation of the member to report, and even be reluctant to engage a member because of the reporting obligation. In addition, reporting without the client's knowledge or consent could result in a claim against the member. Thus the client must be informed that while the member will seek consent to report the information, ultimately, if the consent is not forthcoming, the obligation to the public and the profession will prevail and the member will be obliged to report.
5. A member reporting a matter does not have to carry out an investigation or reach a decision as to whether the rules of professional conduct have been breached. However, it is not enough

simply to have a suspicion that there has been professional misconduct. What must be reported are the facts as known to the member along with any supporting documentation.

6. If a member knows that a matter involving apparent misconduct on the part of another member has come to the Institute's attention, the member does not have a duty to report the matter. The member must report if the member knows that certain facts have been concealed, distorted or otherwise not reported.
7. A member who, having reviewed Rules 211.1 and 211.2 and this interpretation, is in doubt as to whether a matter should be reported should consult Institute staff for advice and guidance. In certain circumstances, such as those described in paragraph 4 above, the member should also consider obtaining legal advice.

## **CI 215 — CONTINGENCY FEES AND SERVICES WITHOUT FEES**

### **INTRODUCTION**

1. A member is entitled to charge for professional services such fees as the member considers to be fair and reasonable for the work undertaken. Generally it is prudent to refer to fees and the basis on which they are to be computed in an engagement letter to the client or potential client.

### **CONTINGENCY FEES**

2. When providing a professional service for a fee payable only where there is a specified determination or result of the service, or for a fee the amount of which is to be fixed, whether as a percentage or otherwise, by reference to the determination or result of the service ("contingent fee"), a member must bear in mind the requirements of Rules 202, 203, 205, and 206. These rules require members to perform their services with integrity and due care; to sustain their professional competence in all functions in which they practice; not to associate with any letter, report, statement or representation which they know or should know is false or misleading; and to comply with the generally accepted standards of practice of the profession.

3. A member must ensure that a contingent fee arrangement in a client engagement does not, in the view of a reasonable observer, create an influence which would impair the member's professional judgement or objectivity with respect to the audit or review of that client's financial statements as referred to in Rules 204.1 and 204.2. For example, a member may be seen to have compromised his or her professional judgement or objectivity with respect to an audit where the member in giving his or her opinion may be seen to be supporting a material amount which is reported in the client's financial statements and upon which the contingent fee is based.

4. The following examples of contingent fees engagements are provided as guidance to assist members in determining whether their professional judgement or objectivity may be compromised with respect to an audit or review engagement or whether the contingent fee engagement would be seen to influence the result of a compilation engagement. These examples are not intended to be exhaustive or conclusive in determining whether a particular engagement for an audit, review or compilation client may be undertaken on a contingent fee basis. In all cases, members must exercise their own professional judgement in determining whether particular engagements may be undertaken on a contingent fee basis in accordance with Rule 215.3.

Examples of engagements where a contingent fee arrangement would not normally be seen to impair professional judgement or objectivity with respect to an audit or review

engagement, or would not normally be seen to influence the result of a compilation engagement, for the same client are:

commodity tax refund claims;

Assisting with tax appeals and preparing notices of objection to tax assessments and reassessments; and  
executive search services.

Examples of engagements where a contingent fee arrangement may be seen to impair professional judgement or objectivity with respect to an audit or review engagement, or may be seen to influence the result of a compilation engagement, for the same client are:

valuation engagements which involve the expression of a professional opinion;

assisting with the purchase or sale of all or part of a business;

financing proposals, the success of which is dependent, in whole or in part, upon the client's financial statements or the client's future oriented financial information;

litigation support and forensic investigations which use financial statements or other financial information of the client or result in reports which impact on or bear a relationship to the client's financial statements;

business interruption insurance claims; and

re-engineering or efficiency studies, the results of which could materially impact on the client's financial statements or other financial information.

The six examples noted immediately above are not listed so as to preclude members from having regard at the time of billing to criteria which include:

(a) the level of training and experience of the persons engaged in the work;

(b) the time expended by the persons engaged in the work;

(c) the degree of risk and responsibility which the work entails;

(d) the priority and importance of the work to the client;

(e) the value of the work to the client; and

(f) any other circumstances which may exist (e.g. fees fixed by a court or other public authority, fees in insolvency work and the administration of estates and trusts which, by statute or tradition, are often based on percentage of realizations and/or assets under administration).

Value billing should not be used, however, to justify what is in substance an otherwise inappropriate contingent fee arrangement.

5. Members are cautioned that professional engagements may be subject to standards of other professional bodies or organizations which must be considered in determining whether contingent fees are appropriate for a particular engagement.

## **CI 217—ADVERTISING AND PROMOTION**

1. It is in the public interest and in the interest of all members of the Institute that members and firms be allowed to advertise or otherwise promote services available and the basis of fees charged. Members should be able to receive publicity, identifying them as members of the Institute, in areas which reflect their competence and knowledge, in matters which are within the scope of activities of members of the Institute, and in matters of civic or public interest. Advertising and publicity should contribute to public respect for the profession and thus to the professional standing of all members. It is the responsibility of the member or firm to ensure that any promotional material produced by or under the control of the member or firm is factual, and that any commentary is not misleading.
2. As guidance to members and firms, the following outlines what is acceptable conduct in a number of areas. Unless specifically noted, this Interpretation also applies to members otherwise engaged or employed, and to firms or corporations engaged in a related business or practice. The objective is to ensure that advertising or other promotional communication is accurate and factual.
3. Members and firms that engage public relations, recruiting or other agents are responsible for ensuring that no activity for which the agent is engaged contravenes the rules. While there are matters in which the use of skilled assistance can be advantageous, it should be recognized that there is an inherent danger of contravention of the Rules and that close control must be exercised to avoid breaches. Public relations, recruitment and advertising copy should be closely scrutinized when engaging the services of agents to ensure that it contains nothing objectionable.
4. A member or firm may be the subject of, or may be referred to, in any bona fide news story (including interviews and commentaries) or may publish any work (including any professional paper, report, article, etc.) related to the member's or firm's professional services, provided that the member or firm uses all best efforts to ensure that none of the contents of such news story or work violates the requirements of Rule 217.

## **FALSE OR MISLEADING ADVERTISING AND PROMOTION**

5. Members and firms should ensure, at all times, that any public reference (in promotional material, websites, stationery, reports, etc.) to themselves, or their services, is accurate. The following are examples of false or misleading references:
  - (a) any implication that the practising unit is larger than it is, such as by use of plural descriptions or other misleading use of words;
  - (b) any implication that a person is a partner of a firm, when the person is not;
  - (c) any implication that a person is entitled to practice as a public accountant, by including his or her name in public announcements of a practising firm if the person is not licensed as a public accountant;
  - (d) any reference to representation or association which is not in conformity with the facts;

- (e) the use of obsolete or out of date information;
  - (f) any reference to particular services of any member, person, or firm where the member, person or firm is not currently able to provide those services;
  - (g) any statement that the practice is restricted to one or more functions, if assignments are accepted in other practice functions;
  - (h) any statement that may create false or unjustified expectations as to the results of an engagement;
  - (i) the use in the letterhead of any member or practising office of the name of a nonmember which is not clearly and separately identified.
6. Any reference to fees which is intended for the information of the public (including prospective clients) should not be misleading. The following are examples of false or misleading fee references:
- (a) fee information if service at the fee specified will not be available on an ongoing basis for a reasonable length of time;
  - (b) a quotation of specific fee information if service at the fee specified is conditional upon the acceptance by the client of other services, unless such condition is disclosed;
  - (c) a “rate per hour” or fee or fee range for specified services, which does not give a reasonable description of the services included;
  - (d) fee information which quotes an unqualified “average rate”, fee or fee range for services when a particular assignment might likely be billed at a significantly higher amount;
  - (e) fee information, using terms such as “from \$X” where fees, rates or ranges are not sufficiently representative of those normally charged.
7. Members and firms should ensure that any controllable public references to them, their services or accomplishments whether written or oral, are clear and factual.

## **ADVERTISING AND PROMOTION - PROFESSIONAL GOOD TASTE**

8. Members and firms should ensure that any advertising or other promotional communication takes into account the following considerations:
- (a) content should not be extravagant or self-laudatory; and
  - (b) advertising or other promotional communications should not appear in media, including electronic media, that might tend to lower public respect for the profession.

## **ADVERTISING AND PROMOTION - UNFAVORABLE REFLECTIONS**

9. Since any member or firm may be able to offer services similar to those offered by others, it is not appropriate for any member or firm to claim superiority with respect to the competence or integrity of any other member or firm.

## **ADVERTISING AND PROMOTION - USE OF THE TERM “SPECIALIST”**

10. Improperly claiming specialist status may violate one or more of the following rules:
  - Rule 201.1, which requires members and firms to act in a manner that will maintain the good reputation of the profession;
  - Rule 202, which requires members to perform their services with integrity and due care;
  - Rule 203.1, which requires members to sustain their professional competence in all functions in which they practise;
  - Rule 210, which requires members and firms to avoid conflicts of interest; and
  - Rule 217.1(d), which requires members to refrain from making statements that cannot be substantiated.

## **SOLICITATION – PROFESSIONAL ENGAGEMENTS**

11. Solicitation is an approach to a client or prospective client for the purpose of offering services. The approach may be made in person, through direct mail (including fax or e-mail) or via a third party such as a telemarketer. Regardless of the method used, the approach must comply with the rules which govern integrity, conflict of interest, payment of commissions and advertising or which otherwise regulate members and firms.
12. Communication with a prospective client should cease when the prospect so requests either directly to the member or firm or through the Institute. Any continued contact will be regarded as harassment, which is contrary to the rule.
13. Participation in a trade or a financial services show is not prohibited by the rules. The conduct of the member or firm at the show must be in accordance with the rules and the follow up of contacts made at the show should be in accordance with Paragraphs 1 and 2.
14. The distribution of technical information such as a tax letter to prospective clients and others is not prohibited.
15. Members and firms may serve the interests of the public and other members of the Institute by presenting educational and informational seminars and may distribute invitations to attend seminars and provide related informational material. Seminars may be advertised as permitted by Rule 217.1. Such advertising may invite the public to request brochures, letters or other descriptive or informational material from the members or firms responsible for the seminar. Members and firms may arrange, promote, present or otherwise be responsible for such seminars, with or without a fee, subject to the rules.

16. A member or firm participating in a seminar arranged for, or promoted by, a non-member shall ensure that any reference to the member or firm at the seminar and in its promotion complies with the rules.

## **SOLICITATION - CLIENTELE OF A DECEASED MEMBER**

17. When a member who is a sole proprietor dies, the member's executors should be provided a reasonable opportunity to arrange for transfer of the deceased member's clients to another member or firm. The Institute may be able to assist the estates of deceased members in such circumstances. It is recognized that, in some cases, clients may require immediate service and may not be able to await the orderly disposal of the practice. Any member or firm who is approached to take over the account of a prospective client who had been served by a deceased member should notify the executor upon assuming the account.

## **ENDORSEMENTS**

18. "Endorsement" means
  - (a) public promotion, support, sponsorship, recommendation, guarantee, sanction or validation of any product or service of another person or entity; or
  - (b) public indication or implication that the member either
    - (i) uses a product or service of another person or entity, or
    - (ii) has an association with a product or service of another person or entity that is of a nature that has enabled the member or firm to formulate an opinion or belief as to the quality of the product or service or the benefits to be derived by the purchasers or users of the product or service; or
  - (c) consent, including by acquiescence, to the use of the member's or firm's name in connection with any of the activities described in (a) or (b).
19. Providing a *WebTrust*<sup>TM</sup> or other assurance service does not constitute an endorsement of the client's products or services.
20. When endorsing a product or service that the member or firm uses in business or professional practice, the member or firm should first make an appropriate investigation or assessment of the product or service so as to be able to express an opinion or state a belief about it.
21. When endorsing a personal product or service, the member or firm should have sufficient familiarity or acquaintance with the product or service to make an informed and considered decision about it.
22. When endorsing any product or service, a member or firm must take care to ensure that the endorsement does not or would not, in the view of a reasonable observer, impair professional judgment or objectivity with respect to an engagement that requires objectivity, such as an audit or review of financial statements.

23. A member or firm must ensure that an endorsement of a product or service is in professional good taste, does not make unfavourable reflections on the competence or integrity of the profession and does not contain any statement that the member or firm cannot substantiate.

## **CI 218 RETENTION OF DOCUMENTATION AND WORKING PAPERS**

- 1 Cases may arise where a member or firm may be required to substantiate procedures carried out in the course of an assignment. If the files do not contain sufficient documentation to confirm the nature and extent of the work done, the member or firm concerned may well have great difficulty in showing that proper procedures were in fact carried out. The importance of adequate documentation cannot be over-emphasized; without it, a member's or firm's ability to outline and defend professional work is seriously impaired.
- 2 There is an obligation to keep the working papers for a reasonable period of time. Unfortunately, it is not possible to give an all-encompassing guideline as to what is reasonable. What is reasonable varies with the circumstances. One of the problems is that an action alleging negligence arises, not when the work alleged to be negligent is done, but when the damage caused by the alleged negligence becomes known or should become known to the person or entity harmed. Working papers should not be destroyed until legal advice has been obtained with respect to the limitation periods in force in the member's or firm's jurisdiction.
- 3 Further, a member or firm should retain documents for a period of time to properly service clients. A general guideline would be:
  - (a) a period of ten years, during which all records are maintained; and
  - (b) a longer period of time, perhaps indefinitely, or the actual time period where required specifically by statute, for all useful files, information and records which may assist the member to properly service clients. Such useful files, information and records could include:
    - financial statements
    - agreements, contracts and leases
    - investment/share capital information
    - written opinions
    - tax files and assessment notices
    - detailed continuity schedules for such items as fixed assets and future income taxes
    - other files, information and records as appropriate.
- 4 Members and firms may find it helpful to take reasonable steps to segregate information that is property of the client ("client information") from information that is proprietary to the firm ("proprietary information") or to ensure that they have the ability to easily segregate such client information. The client may choose to engage another accountant in the future, or access to the client information may be demanded through litigation discovery or other legal means. Therefore, it is in the interest of the member or firm to be able to provide client information without also disclosing proprietary information. Accordingly, client information, including books and records, general ledgers, account groupings, account compositions, continuity schedules and similar client information should either be maintained separately or be readily separable from audit or review programs and working papers, tax review documentation and other proprietary information.
- 5 When the member or firm maintains the client's books and records on behalf of the client, it will be particularly helpful if such client books and records are maintained separately from documentation related to any other service that the member or firm may provide. Copies of the books and records should be provided to the client regularly.

### Changes in Professional Appointments

1. Many members in the practice of public accounting and auditing are unclear on the purpose of Rule 302 which relates to changes in professional appointments, their impression being that on receipt of a communication from a proposed successor they may object to him assuming the appointment and thus prevent the change. There is no such intention; the purpose of the rule is as follows:
  - (a) It protects a potential successor from accepting an appointment before he has knowledge of the circumstances under which the previous accountant's services were discontinued. Knowledge of these circumstances might well influence him against accepting the engagement which is offered.
  - (b) If two separate practitioners are dealing with the same client, one as incumbent and one as successor, they should only do so in complete cooperation. There should be no period when each one believes he is the incumbent. They must both be aware of the proposed change before the successor accountant accepts the appointment. In all circumstances relating to changes in professional appointments the recommended procedure outlined in paragraph 2—below—should be followed.
2. When a member has been asked by a prospective client to accept a professional appointment it is recommended that he advise the client that the incumbent should be notified of the proposed change by the client. The member should then enquire of the incumbent whether there are any circumstances he should take into account which might influence his decision whether or not to accept the appointment. The member should not take up any work on the account until he has communicated with the incumbent, except that in the client's interest, acceptance of the offered appointment should not be unduly delayed through the failure of the incumbent to reply, if every reasonable effort has been made to communicate with him. As a matter of professional courtesy the incumbent should respond promptly to a communication of this nature. If there are no circumstances that the member should be made aware of, a simple response to this effect is all that is necessary. If, on the other hand, the incumbent is aware of circumstances that the member should take into account which might influence his decision whether or not to accept the appointment, he will need to consider first the question of confidentiality. If it appears that the circumstances cannot be disclosed because of confidentiality, the response to the member should state that there are, in the opinion of the incumbent, circumstances which should be taken into account, but that they cannot be disclosed without the consent of the client. Although the circumstances which the incumbent has in mind may be matters of public record, the incumbent must still consider whether confidentiality precludes him from disclosing the exact circumstances to his successor. Where confidentiality is in doubt, legal advice should be sought.
3. The successor should also enquire of the predecessor whether there is any ongoing business of which he should be aware, in order to ensure that the client's interests are protected. On the part of the predecessor, there must be a readiness to co-operate with the successor, recognizing that the client's interests are paramount. Generally, a member should be prepared to transfer promptly to the client or, on the client's instructions, to the newly-appointed accountant, all books and documents belonging to the client which are in his possession, whether or not there are monies owed to him by the client.

4. A member should also be prepared to supply reasonable information to his successor about the work being assumed. Where the time and trouble involved in giving information to the new accountant is not significant it should be regarded in normal circumstances, as best professional practice to make no charge for this work.
5. The attention of members is drawn to the provisions of Section 166 of the Canadian Business Corporations Act:

"166. Any oral or written statement or report made under this Act by the auditor or former auditor of a corporation has qualified privilege."

The apparent purpose of this provision is to provide the auditor or former auditor with legal protection against liability which might otherwise flow from a statement or report made by him pursuant to the provisions of the Act. A member wishing to rely on this provision should first ascertain that the corporation of which he is the auditor or former auditor was incorporated or continued under the above statute during the period he was an auditor. Further, members should note that the question whether the auditor or former auditor is entitled to the protection afforded by the provision can be answered only in particular cases. Accordingly, it is recommended that a member wishing to place reliance on S.166 should, for his own protection, take legal advice as to whether the report or statement he wishes or may be called upon to make is of the kind that is referred to in the statute.

### **CI 303—CO-OPERATION WITH SUCCESSOR**

1. When a client decides, for any reason, to change from one practitioner to another, the change should be facilitated on the basis of the following fundamental assumptions:
  - (a) the client's interests be placed ahead of the interests of the member or firm;
  - (b) the client is free to have work performed by the practitioner of choice; and
  - (c) professional courtesy and co-operation be maintained in complying with the client's wishes.
2. A member or firm should supply reasonable information to the successor about the client. Where the time and inconvenience in giving the information to the successor is not significant there should normally be no charge for this work.
3. A reasonable request for information related to the client includes an opportunity for the successor to discuss with the predecessor the following:
  - (a) the client's accounting policies and consistency of application;
  - (b) the work carried out by the predecessor with respect to material balances in the client's financial statements; and
  - (c) the financial statement groupings and account balance composition (for example, future income taxes) where the client does not have the information.

Members and firms are also reminded that the *CICA Handbook – Assurance* includes requirements with respect to obtaining audit evidence related to opening balances. Professional courtesy dictates that the predecessor should co-operate with the successor for the purpose of meeting this requirement through discussion and review of working papers. In addition, the client's interests are likely to be best served when the predecessor co-operates as fully as possible with successors for this purpose. Reasonable opportunity to review and discuss working papers does not preclude

the use of appropriate waivers or releases. However, appropriate waivers or releases should not include requirements for confidentiality which would contravene the successor's obligation to report breaches by another member pursuant to Rule 211 or prevent the successor from otherwise properly serving the best interests of the client.

4. Notwithstanding the fact that the best interests of the client are served by co-operation between accountants in the transfer of client information and the provision of other reasonable information necessary to meet professional requirements, Rule 303 is not intended to require the transfer of certain proprietary information, and accordingly, members and firms are not expected to supply copies of audit or review programs and working papers or tax review documentation. Ordinarily, predecessors are not expected to supply copies of more than the previous year's financial statements and applicable tax returns, unless the member or firm is remunerated for time and expenses to do so.
5. Property of the client does not include information that is proprietary to the firm, such as audit or review programs and working papers, review documentation, software or other proprietary material or information.
6. The medium that facilitates a timely and efficient transfer may vary depending on the nature of the engagement and the nature of the property of the client. For greater clarity and without limiting the general meaning of "property of the client", such property includes original transaction documents (cheques, receipts, invoices, for example), banking records, ledgers and similar records. It would also ordinarily include tax returns and information related to financial statement groupings, account balance composition and continuity schedules that have been prepared by the predecessor accountant for the client's benefit. In addition, it includes any of the foregoing or other property of the client that is readily available in electronic form where the client does not also have an electronic copy of the records or information.
7. "Property of the client that is readily available in electronic form" is not intended to include electronic information that cannot be easily segregated from proprietary information of the member or firm. Basic financial information such as trial balances, leadsheets and continuity schedules should always be provided, but need not be provided electronically if they are incorporated into software that includes audit or review programs and working papers or tax review documentation. Accordingly, while members and firms should always consider which readily available transfer medium will best serve the interests of the client, members and firms are not required to provide client information electronically in every case.
8. Council Interpretation 218 (4) includes guidance on facilitating the separation of information that is property of the client from proprietary information of the firm. Such separation of information is recommended to facilitate the ease with which a predecessor can co-operate with a successor to properly serve the client's interests.

#### **CI 401—PRACTICE NAMES**

1. It is in the interest of all members of the Institute that members and firms be allowed to conduct their practices under names which reflect their individual preferences and which are appropriate for their particular marketplaces. This interpretation sets out guidance for members and firms in the selection of practice names and in the identification with other professional service organizations.

2. Members, firms and related businesses or practices should ensure, at all times, that any information contained in their practice names about themselves, their firms or their services is accurate. The following are examples of practice names containing inappropriate information:
  - (a) any implication in the practice name that the practising unit is larger than it is, such as by use of plural descriptions or other misleading use of words. The use of “and Company” or similar wording in a practice name is permitted, if it is not misleading with respect to the total number of full-time equivalent persons providing professional services within the practice;
  - (b) any implication in the practice name that a member is a partner or a former partner of a practice, when the member is not;
  - (c) any reference to representation or association which is not in conformity with the facts;
  - (d) any reference in the practice name to particular services provided where the practice is not currently able to provide those services;
  - (e) any statement in the practice name that may create false or unjustified expectations as to the results of a particular engagement.
3. When a member, firm or related business or practice participates in an organization, whose members practise public accounting internationally, with professional engagements accepted and reports or opinions issued in the international name, the member, firm or related business or practice may refer to such international name on professional stationery and in name plates, directory listings, announcements and brochures by using the term "internationally", or "international firm". General references to "offices throughout the world" or "offices in principal cities throughout the world" imply broad coverage and should be used only where the international organization's members practise public accounting in many countries.
4. A member, firm or related business or practice may have an arrangement with another person or organization whereby one acts for the other in a particular location, and the assignment, by agreement, may be in the name of one of them. In such circumstances it is appropriate, if desired, for the member, firm or related business or practice to refer to the fact of such representation by a suitable reference to the location and the name and/or address and professional designation of the representative, with a description of the relationship as being "represented by". If representation arrangements exist in a number of locations it may not be possible to give full details of each, and in such case it would be appropriate, if desired, to refer to the fact of representation in the particular locations, specifying the locations individually. Generally references such as "represented throughout the world", which may not be factual and may be misleading, should be avoided. In any public reference to representation, the representative must be a person or organization practising public accounting.

5. Members, firms and related businesses or practices may associate themselves with international organizations which do not practise public accounting but which consist of members who are practising public accounting and which exist primarily to provide their members with access to international public accounting services. In these cases it is appropriate to make public reference on professional stationery and elsewhere to membership in a bona fide international organization by using a term such as "a member of (name), an international association of accounting firms". Terms such as "internationally" or "international firm" should not be used. General references such as "members throughout the world" should be used only where there are in fact members of the organization in many countries. References such as "represented throughout the world" should be avoided unless they are factual and not misleading.

6. Members, firms and related businesses or practices should ensure that their practice names or styles are not self-laudatory and do not claim superiority over any other member, firm or related business or practice. Care should be taken in using the word "The" in the firm name so that it does not imply exclusivity.

Practice names that might tend to lower public respect for the profession should not be used. Care should also be exercised with respect to the use of acronyms.

7. In general, approval will be given to non-personal firm names unless they are misleading or contravene professional good taste. However, there may be certain other considerations which will affect the approval decision. A practice name that is so similar to that of another firm registered in the same area as to cause confusion in the minds of the public may not be approved. Consideration will also be given to cultural sensitivities in deciding whether to approve a non-personal firm name.

8. Council, in its discretion, is permitted to be flexible in transitional situations. For example, a member engaged in the practice of public accounting as a sole proprietor or, where permitted, an incorporated professional, may apply to Council for permission to practise for a specified period of time under both the member's approved name and, with the predecessor's written authorization, the name used by a predecessor sole proprietor or firm. Other situations where transitional flexibility may be granted include those where a previously approved firm name becomes inappropriate. An example of such a situation would occur when, due to the departure of a partner, the firm name becomes misleading with respect to the size of the firm. In such cases, the member or firm may apply to Council for permission to continue to use the name for a specified period of time.

#### **CI 404— OPERATION OF MEMBERS' OFFICES**

1. The purpose of the Rule is to ensure that the client's public accounting needs will be met in each instance by properly qualified professional personnel.
2. A part-time office is a practising office which is operated by a member who is practicing out of the office on less than a full-time basis. Such an office is one where the member having personal charge and management is not normally accessible to meet the needs of clients throughout the usual business hours of the community in which the office is located.

3. A part-time office may be operated by a member in public practice if the following conditions are met:
  - (a) the part-time office is under the personal charge and management of a member who is responsible for the work of any assistants;
  - (b) a member is accessible to meet the needs of the clients;
  - (c) assistants are adequately trained and supervised; and
  - (d) no reference to a part-time office shall be made on letterhead, other professional cards or other published material.